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LABOR LAW SUCCESSORSHIP: A CORPORATE LAW APPROACH

Edward B. Rock*
and Michael L. Wachter**

INTRODUCTION

Courts have struggled repeatedly to define the legal obligations of the buyer of a business that has unionized workers. This is the domain of the "labor law successorship doctrine."¹ Beginning with *John Wiley & Sons, Inc. v. Livingston*² in 1964, the Supreme Court has addressed the issue five times over the ensuing years.³ The National Labor Relations Board (the Board) and the lower courts have decided countless successorship cases. Despite or perhaps because of this constant attention, many commentators have argued that the doctrine — with its distinction among mergers, stock sales, asset sales, and shifts of work — is confusing, formalistic, and arbitrary.⁴

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1. For a comprehensive account, see 1 *THE DEVELOPING LABOR LAW* 761-850 (Patrick Hardin ed., 3d ed. 1992).

2. 376 U.S. 543 (1964).

3. *Fall River Dyeing & Finishing Corp. v. NLRB*, 482 U.S. 27 (1987); *Howard Johnson Co. v. Detroit Local Joint Executive Bd.*, 417 U.S. 249 (1974); *Golden State Bottling Co. v. NLRB*, 414 U.S. 168 (1973); *NLRB v. Burns Intl. Sec. Servs., Inc.*, 406 U.S. 272 (1972); *John Wiley & Sons, Inc. v. Livingston*, 376 U.S. 543 (1964).

4. See, e.g., DOUGLAS L. LESLIE, *LABOR LAW IN A NUTSHELL* 289-300 (3d ed. 1992) ("Supreme Court cases on the rights of a union in successorship situations have traveled a twisted path reaching results that are often susceptible to manipulation by a successor employer who wants to rid himself of a union."); David L. Benetar, *Successorship Liability Under Labor Agreements*, 1973 WIS. L. REV. 1026, 1026 (noting a fundamental difference in judicial philosophy between *Wiley* and *Burns*), 1036 (calling *Wiley* and *Burns* "decisions headed in opposite directions"); Sue J. Henry, *Is There Arbitration After Burns?: The Resurrection of John Wiley & Sons*, 31 VAND. L. REV. 249, 249-50 (1978) ("The development of the federal labor law dealing with the obligations of a successor corporate employer based upon the predecessor employer's collective bargaining agreement — the so-called 'successorship doctrine' — has been confusing, incomplete and, apparently, inconsistent.") (footnote omitted); Charles J. Morris & William Gaus, *Successorship and the Collective Bargaining Agreement: Accommodating Wiley and Burns*, 59 VA. L. REV. 1359, 1360 (1973) ("[T]he *Wiley* and the *Burns* decisions exist at present side by

Critics from the labor law perspective have viewed the development of the doctrine as largely wrong, as an unfortunate dilution of worker protection, and as an indefensible falling away from the protections afforded workers under *Wiley*.⁵ The courts themselves have recognized the difficulties in the doctrine.⁶ Commentators from a corporate law perspective have been equally but oppositely perplexed, unable to discover any principled basis for what seems to be excessive worker protection.⁷

In this article, we take an approach fundamentally different from that of the labor law commentators. We start from a broader perspective than is common: successorship is as important an issue for corporate law as it is for labor law. Given that the two principal inputs to the firm are labor and capital, it would be surprising if the laws for labor law successorship were completely different from the laws for corporate law successorship. To the extent that differences exist, those differences should hinge upon differences between the employees' and the creditors' relationships with the firm.

What distinguishes the employees' relationship from that of others who contract with the firm is what economists term the "internal labor market" — the ongoing web of contractual and noncontractual understandings governing the employer-employee relationship which, when efficient, yields a surplus above that available in the external labor market. In this article, we show that internal-labor-market theory provides the element that the cases and the commentary have most

side, presenting the lower courts with the vexing task of attempting to reconcile their seemingly irreconcilable holdings."); Lock Holmes, Comment, *Contractual Successorship: The Impact of Burns*, 40 U. CHI. L. REV. 617 (1973) ("*Burns* and *Wiley* are not easily reconciled."); Note, *The Impact of Howard Johnson on the Labor Obligations of the Successor Employer*, 74 MICH. L. REV. 555, 555 (1976) (noting that the Supreme Court "has reached seemingly inconsistent conclusions" in successorship cases).

5. 376 U.S. at 548. See generally LESLIE, *supra* note 4, at 289-300; Note, *The Bargaining Obligations of Successor Employers*, 88 HARV. L. REV. 759 (1975); James Severson & Michael Willecoxon, Comment, *Successorship Under Howard Johnson: Short Order Justice for Employees*, 64 CAL. L. REV. 795 (1976). But cf. Keith N. Hylton & Maria O. Hylton, *Rent Appropriation and the Labor Law Doctrine of Successorship*, 70 B.U. L. REV. 821 (1990) (expressing views consistent with those developed herein).

6. For example, in *Howard Johnson* the Court stated: "The courts below recognized that the reasoning of *Wiley* was to some extent inconsistent with our more recent decision in [*Burns*]." 417 U.S. at 254. The Court added:

Particularly in light of the difficulty of the successorship question, the myriad factual circumstances and legal contexts in which it can arise, and the absence of congressional guidance as to its resolution, emphasis on the facts of each case as it arises is especially appropriate. The Court was obviously well aware of this in *Wiley*, as its guarded, almost tentative statement of its holding amply demonstrates.

417 U.S. at 256.

7. RONALD J. GILSON & BERNARD S. BLACK, *THE LAW AND FINANCE OF CORPORATE ACQUISITIONS* 1149-52 (Supp. 1993).

lacked: a *positive* theory of labor law successorship.⁸ To the extent that one believes that courts should help parties maximize their joint gains, at least when doing so imposes no costs on others, the economics of internal labor markets provides a normative theory as well.

In applying corporate law's successorship taxonomy to organize the labor law cases, we reach a surprising conclusion. Although the courts, the Board, and many labor law commentators have claimed that the form of the corporate transaction does not, and should not, matter — that "form" should not be elevated over "substance" — the contrary seems true. We can almost perfectly predict the outcome of the cases based on the corporate form of the transaction. By showing why the corporate form of a transaction matters in labor law, this article provides a relatively simple, positive explanation of what heretofore has been a confusing area of labor law.⁹

We proceed as follows. In Part I, we provide a taxonomy of the background corporate law successorship doctrine, which governs the rights of creditors other than employees when a business is sold. In Part II, using a parallel taxonomy, we describe the current state of labor law successorship doctrine, noting the places where it diverges from the more general corporate law doctrine. In Part III, we introduce and summarize the economics of internal labor markets. Finally, in Part IV, we use the economics of internal labor markets to understand labor law successorship doctrine and to explain its unique features. We conclude by summarizing the respective contributions that the form of the transaction and the dynamics of the employment relationship make to a proper understanding of successorship doctrine.

I. SUCCESSORSHIP IN CORPORATE LAW: A TAXONOMY

In corporate law, successorship liability issues revolve around two distinctions. The first distinction is between mergers and asset sales. State corporate law codes provide that, when two firms merge, the surviving firm (or the new firm) succeeds to the liabilities of the merged firm or firms automatically, as a matter of law.¹⁰ The same rule applies to sales of stock: when a firm is acquired through the acquisition of its stock, the firm automatically retains all prior liabili-

8. As such, our general approach resembles Kenneth G. Dau-Schmidt, *A Bargaining Analysis of American Labor Law and the Search for Bargaining Equity and Industrial Peace*, 91 MICH. L. REV. 419 (1992).

9. Through our taxonomy we intend largely to replace the traditional labor law analysis that turns on the duty at issue, such as the duty to arbitrate, the duty to adhere to the contract, the duty to bargain, and the duty to redress unfair labor practices.

10. See, e.g., DEL. CODE ANN. tit. 8, § 259 (1991).

ties because the corporation has an independent legal existence. In contrast, when the successor firm acquires some or all of the assets of the predecessor firm, the general rule is that the successor does not assume any liabilities, except as negotiated.¹¹ As described below, the general rule has always been subject to exceptions, and, in recent years, several new exceptions have emerged.

Why has corporate law traditionally drawn such a sharp distinction between mergers and asset sales? A core justification is a desire to protect creditors while minimizing transaction costs.¹² The merger statute provides an inexpensive, off-the-rack form to transfer a whole business as a going concern with minimal interruption of established legal and economic relationships.¹³ Thus, transferring control by a merger or stock sale typically leaves intact all contracts, leases, and licenses.¹⁴

When, on the other hand, the parties desire to transfer assets without transferring the entire business as a going concern, an asset sale is preferable.¹⁵ Thus, if only a portion of the assets are being transferred, if a firm is being liquidated after business failure, or if the seller values some significant assets or liabilities more highly than the buyer does, the parties typically will choose to structure the transaction as a sale of assets, rather than as a merger, and identify specifically which assets and liabilities are transferred.¹⁶ So long as the buyer pays fair market value for the assets it buys, creditors of the seller, subject to the qualification discussed below,¹⁷ are made better off by a rule that permits the

11. 15 WILLIAM M. FLETCHER, FLETCHER CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS § 7122 (perm. ed. rev. vol. 1990).

12. See generally ROBERT C. CLARK, CORPORATE LAW 401-61 (1986) (discussing the distinction between mergers and asset sales and describing the respective differences in legal consequences).

13. The statute performs this function both when two firms of equal size merge and when a larger firm absorbs a smaller one.

14. See, e.g., DEL. CODE ANN. tit. 8, § 259(a) (1991).

15. The Delaware Supreme Court, for example, has drawn precisely this distinction: "A merger ordinarily contemplates the continuance of the enterprise and of the stockholder's investment therein, though in altered form; a sale of all assets . . . ordinarily contemplates the liquidation of the enterprise. . . . They are, in general, distinct and designed for different ends." *Sterling v. Mayflower Hotel Corp.*, 93 A.2d 107, 112 (Del. 1952).

16. Suppose, for example, that the seller's assets include a large piece of undeveloped real estate which the seller's shareholders value at \$2 million, but which the buyer only values at \$1 million. If the seller retains the real estate, the parties have an additional \$1 million gain from trade to divide. In such a case, it may be cheaper to structure the transaction as an asset sale — that is, a sale of assets other than the real estate — rather than as a merger followed by a sale of the real estate back to the sellers. Similarly, if the seller has a liability which it values at minus \$1 million, while the buyer believes that it is likely to cost the firm \$2 million, the parties will again jointly maximize gains by structuring the transaction as an asset sale, leaving the liability with the seller while transferring everything else to the buyer. See generally DALE A. OESTERLE, THE LAW OF MERGERS, ACQUISITIONS, AND REORGANIZATIONS 155-56 (1991).

17. See *infra* text following note 22.

parties to allocate assets and liabilities to the highest valuing user.

The value of appropriate and predictable transactional forms for common transactions bears emphasis. Although in theory one often can, with sufficient paperwork, use an asset sale to replicate a merger, the difficulties and costs can be significant. Securing the consent of third parties to an assignment of a lease or a license provides an opportunity for those parties to withhold consent. By contrast, a statutory merger leaves all such agreements in effect as a matter of law, absent contractual commitments to the contrary.

While the legal distinction between mergers and asset sales is a valuable one, it provides its own opportunities for abuse. Often the choice of transactional form will be driven by tax considerations — at best only marginally related to minimizing transaction costs or allocating assets to the highest valuing user. Tax law accordingly seeks to distinguish between economically and tax-driven corporate reorganizations.¹⁸

More relevant for our purposes is a second motivation. All state corporation codes provide for the dissolution of corporations. Traditionally, state codes have permitted corporations to dissolve and pay out surplus to shareholders after paying off all known creditors. New York's Business Corporation Law, for example, provides for a corporation's voluntary dissolution upon authorization by shareholders.¹⁹ After dissolution, the corporation winds up its affairs, paying off its creditors and distributing any surplus to shareholders.²⁰ New York's statute, like most traditional corporate law statutes, bars claims of creditors who come forward after the statutorily mandated notice and claims period.²¹ As to known creditors, this system is satisfactory so long as it prevents fraudulent conveyances.²² If the asset seller re-

18. See generally BORIS I. BITTKER & JAMES S. EUSTICE, *FEDERAL INCOME TAXATION OF CORPORATIONS AND SHAREHOLDERS* ch. 14 (5th ed. 1987); 2 MARTIN GINSBURG & JACK LEVIN, *MERGERS, ACQUISITIONS, AND LEVERAGED BUYOUTS* ¶ 609 (1993).

19. N.Y. BUS. CORP. LAW § 1001 (McKinney 1986).

20. N.Y. BUS. CORP. LAW § 1005 (McKinney 1986).

21. In particular, the statute provides:

(a) At anytime after dissolution, the corporation may give a notice requiring all creditors and claimants, including any with unliquidated or contingent claims and any with whom the corporation has unfulfilled contracts, to present their claims in writing and in detail at a specified place and by a specified day, which shall not be less than six months after the first publication of such notice. . . .

(b) . . . [C]laims which are not timely filed as provided in such notice except claims which are the subject of litigation on the date of the first publication of such notice . . . shall be forever barred as against the corporation, its assets, directors, officers and shareholders, except to such extent, if any, as the court may allow them against any remaining assets of the corporation in the case of a creditor who shows satisfactory reason for his failure to file his claim as so provided.

N.Y. BUS. CORP. LAW § 1007 (McKinney 1986).

22. For examples of the protection against fraudulent conveyance, see the UCC's bulk trans-

ceives fair value for the assets, existing creditors of the seller are no worse off and, when the seller dissolves, have an opportunity to present their claims for payment ahead of any distributions to shareholders.

But this statutory structure provides an opportunity for asset buyers and sellers to share the gains of jointly externalizing risk onto unknown future tort creditors — that is, “long-tail tort claimants.” Suppose, for example, that Firm *X* makes widgets that tend to explode after twenty years. If Firm *X* continues, it will be liable for the damages the exploding widgets cause. But suppose that Firm *Y* buys only the assets of Firm *X*, and then Firm *X* dissolves after paying all current and contingent creditors. Under the traditional corporate law framework, when the widgets begin to explode twenty years later, the victims will be without recourse. If the victims were to sue Firm *Y*, Firm *Y* would argue that it acquired only the assets of Firm *X*, not the liabilities, and is therefore not liable. If the victims were to sue Firm *X*, they would find that Firm *X* no longer exists; even if the victims could trace the former shareholders of *X*, the shareholders would argue that the law governing the dissolution of corporations bars the claims. Such externalization is obviously inefficient: because of asymmetric information, the future victims cannot negotiate an appropriate price to bear the risk of explosion, and widget manufacturers therefore will not internalize the full costs of widgets.

One solution to this problem would be to eliminate the distinction between mergers and asset sales with respect to liability, either in general or with respect to unknown claimants, by adopting a rule that asset buyers and sellers are jointly and severally responsible for all — or all contingent or all future — liabilities of the seller. A broad-scale elimination of the distinction between mergers and asset sales would eliminate externalization, but at the cost of interfering with the efficient allocation of assets and liabilities.

The traditional legal response has attacked the problem from this direction, but in a modest form. The traditional exceptions to the no-liability rule have imposed liability on the asset purchaser when: (a) the purchaser expressly or implicitly agrees to assume some or all of the liabilities of the seller; (b) the asset sale results in a “de facto merger” of the selling corporation with or into the purchasing corporation; (c) the purchasing corporation is a “mere continuation” of the selling corporation; or (d) the transaction amounts to a fraud on the

creditors.²³

More recently, in response to the problem posed by long-tail claimants and the perceived inadequacy of the traditional exceptions, some courts have expanded corporate successor liability in a number of directions.²⁴ The most prominent extensions have been the "product line"²⁵ and the "continuity of enterprise" exceptions.²⁶ Under the product-line exception, an asset purchaser bears liability for injuries caused by the predecessor's products when it continues to manufacture the same line of products under the same name and holds itself out to potential customers as the same enterprise.²⁷ The continuity-of-enterprise doctrine represents an expansion of the traditional de facto merger exception. While the de facto merger exception requires that the assets be sold for stock because such a transaction is the functional equivalent of a statutory merger, the continuity-of-enterprise exception dispenses with that requirement on the grounds that sales for stock and sales for cash should receive equal treatment.

A second, more recent approach has focused directly on the asset seller by modifying the dissolution provisions to provide greater protection for long-tail tort claimants. Thus, the Revised Model Business Corporation Act extended the claim period to five years on the assumption that most of the long-tail claims would arise during that

23. *Polius v. Clark Equip. Co.*, 802 F.2d 75, 78 (3d Cir. 1986); 15 FLETCHER, *supra* note 11, §§ 7122-7123.05. For a recent survey of successorship law, see Howard Shecter, *Successor Liability in Asset Acquisitions*, in *ACQUIRING OR SELLING THE PRIVATELY HELD COMPANY* 1992, at 421 (PLI Corporate Law & Practice Handbook Series No. 775, 1992).

24. For important discussions of successorship liability in the product liability context, see Mark J. Roe, *Mergers, Acquisitions and Tort: A Comment on the Problem of Successorship Corporation Liability*, 70 VA. L. REV. 1559 (1984); Alan Schwartz, *Products Liability, Corporate Structure and Bankruptcy: Toxic Substances and the Remote Risk Relationship*, 14 J. LEGAL STUD. 689, 715-18 (1985). In addition to the exceptions discussed in the text, a federal common law of successorship liability under CERCLA and other environmental statutes has developed. For an economic analysis of successorship liability under CERCLA, and a citation to the relevant cases, see Merritt B. Fox, *Corporate Successors Under Strict Liability: A General Economic Theory and the Case of CERCLA*, 26 WAKE FOREST L. REV. 183 (1991). A discussion of CERCLA is beyond the scope of this article.

25. *Ray v. Alad Corp.*, 560 P.2d 3 (Cal. 1977); *Ramirez v. Amsted Indus., Inc.*, 431 A.2d 811 (N.J. 1981).

26. *Turner v. Bituminous Casualty Co.*, 244 N.W.2d 873 (Mich. 1976); see also *Andrews v. John E. Smith's Sons Co.*, 369 So. 2d 781 (Ala. 1979). But see the following cases rejecting the "continuity of enterprise" exception: *Nissen Corp. v. Miller*, 594 A.2d 564 (Md. 1991); *Niccum v. Hydra Tool Corp.*, 438 N.W.2d 96 (Minn. 1989); *Jones v. Johnson Mach. & Press Co.*, 320 N.W.2d 481 (Neb. 1982); *Schumacher v. Richards Shear Co.*, 451 N.E.2d 195 (N.Y. 1983); *Downtowner, Inc. v. Acrometal Prods., Inc.*, 347 N.W.2d 118 (N.D. 1984); *Ostrowski v. Hydra-Tool Corp.*, 479 A.2d 126 (Vt. 1984); *Fish v. Amsted Indus., Inc.*, 376 N.W.2d 820 (Wis. 1985). See also *Hamaker v. Kenwel-Jackson Mach., Inc.*, 387 N.W.2d 515 (S.D. 1986) (declining to apply the doctrine on the facts of the case).

27. See cases cited *supra* note 25. Generally, even those courts that apply the product-line exception will not do so if the asset seller still exists. *Conway v. White Trucks*, 885 F.2d 90 (3d Cir. 1989).

period.²⁸

Delaware has taken a different and more innovative approach.²⁹ Like the traditional approach, section 281(b) of the Delaware General Corporate Laws requires that a dissolving corporation make provision to pay all contingent, conditional, or unmatured contractual claims *known* to the corporation — the traditional rule. Section 281(b) also requires, however, that a dissolving corporation

make such provision as will be reasonably likely to be sufficient to provide compensation for claims that have not been made known, or that have not arisen, but that, based on facts known to the corporation . . . are likely to arise or to become known . . . prior to the expiration of an applicable statute of limitation.³⁰

Section 281(b) thus requires the dissolving corporation to make provision for long-tail claimants.

Proceeding directly under section 281(b), however, poses substantial risks to the directors and shareholders of the dissolving corporation because the question whether or not sufficient provision for future claims has been made will inevitably be litigable and judged at least partly by hindsight. To reduce this risk, Delaware provides an innovative safe harbor procedure for complying with the mandate of section 281(b). Under section 280, the mandate of section 281(b) is met when, after notice and a number of other steps, the Chancery Court determines (1) “the *amount* and *form* of security that *will be sufficient* to provide compensation to any claimant who has rejected the [Corporation’s] offer for security”;³¹ and (2) “the *amount* and *form* of security which *will be reasonably likely* to be sufficient to provide compensation for claims that have not been made known . . . or that have not arisen but . . . are likely to arise or to become known . . . prior to the expiration of applicable statutes of limitation.”³²

Once the corporation has posted the security required by the Chancery Court and paid other claims determined to be owed, it may distribute any remaining assets to the shareholders.³³ Under these circumstances, shareholders will have no liability for any claims begun after the three-year winding up period established by section 278.

28. REVISED MODEL BUSINESS CORP. ACT § 14.07 & cmt. (ABA Comm. on Corporate Laws 1984) (amended 1991). The RMBCA thus leaves claimants whose claims do not arise within the five-year period without any protection beyond the common law exceptions.

29. In the discussion that follows, we largely follow Chancellor Allen’s path-breaking and penetrating discussion in *In re Rego Company*, No. CIV.A.11651, 1992 WL 302304 (Del. Ch. Oct. 16, 1992).

30. DEL. CODE ANN. tit. 8, § 281(b) (1974).

31. DEL. CODE ANN. tit. 8, § 280(c)(1) (1974) (emphasis added).

32. DEL. CODE ANN. tit. 8, § 280(c)(2) (1974) (emphasis added).

33. DEL. CODE ANN. tit. 8, § 282 (1974).

The Delaware procedure thus provides a mechanism for protecting long-tail claimants while preserving both the repose offered by the traditional corporate law statutes and the useful legal distinction between mergers and asset sales. To the extent that the procedure forces corporations to make provisions for long-tail claimants, it thereby blocks the attempt to impose risk on future victims without compensation while minimizing interference with the alienation of corporate assets.

Both of the corporate law strategies focus primarily on the asset seller and the problems posed for claimants after the asset seller has disappeared. Modifications of the dissolution statutes address the problem faced by long-tail tort claimants directly. By limiting a corporation's ability to dissolve and cut off future claims, these modifications help preserve long-tail tort claimants' priority over shareholders in the distribution of the old firm's assets.

By contrast, both the old and the new exceptions to the general rule of no liability on asset purchasers take an indirect approach. By imposing liability on the asset purchaser, the law attempts to use the typically blameless asset purchaser as a conduit to impose the cost of risk on the original manufacturer.³⁴ If the asset purchaser knows that it will be responsible for future harm caused by the asset seller's products, the purchaser will internalize those costs by paying a lower price for the assets.³⁵

Corporate law successorship doctrine can thus be summarized in the following two-by-two matrix:

TAXONOMY OF CORPORATE LAW SUCCESSORSHIP DOCTRINE

	Merger/Stock Sale	Sale of Assets
Known Claimants	(1) Automatic liability for all obligations of old firm.	(3) Liability for seller's obligations only if expressly or implicitly assumed.
Unknown Claimants	(2) Automatic liability for all obligations of old firm.	(4) Liability for seller's obligations under exceptions to general rule, for example, express or implicit assumption, <i>de facto</i> merger, mere continuation, fraud, product line continuity.

As the previous discussion demonstrates, the merger-asset sale distinction in corporate law is a *formal* distinction that corresponds to *real* differences in the nature and costs of transactions. At the same

34. See Michael D. Green, *Successor Liability: The Superiority of Statutory Reform to Protect Products Liability Claimants*, 72 CORNELL L. REV. 17, 28, 40 (1986).

35. *Id.*

time, the distinction between mergers and asset sales for liability purposes provides an opportunity for socially unproductive strategic behavior, behavior that the courts and legislatures have attempted to prevent without losing the benefits of the original distinction. As we will demonstrate, both of these features characterize the analogous distinctions in labor law.

II. SUCCESSORSHIP IN LABOR LAW: A TAXONOMY

Labor law and corporate law give different meanings to the term *successor*. In corporate law, *successor* refers to the surviving firm that acquires control of the firm either through a sale of stock, a merger, or a sale of assets. In labor law, the term *successor* is generally limited to the asset purchaser who hires a sufficient number of the old firm's workers to constitute a majority of the new labor force.³⁶ That courts and commentators often use the term as a legal conclusion rather than as a descriptive category further complicates matters. Because of these different uses of the term, we will try generally to avoid it and use more specific and descriptive categories.

The same two-by-two matrix that organizes the corporate law successorship doctrines provides a basis for organizing the multifarious elements of labor law successorship doctrine. In this Part, we provide a taxonomy of the main principles of the law, while acknowledging — largely in footnotes — those cases that depart from the general rule. Labor law cases, with only a few exceptions, are consistent with the taxonomy. This consistency may surprise labor law scholars. The labor law cases frequently mention that they are elevating substance over form, and that the corporate form of the transaction is immaterial. In fact, however, one can predict the outcome of all but a few cases by the corporate form of the transaction.

Labor law, like corporate law, incorporates a fundamental distinction between mergers and asset sales. In addition, the labor law successorship cases present a third category absent from the corporate cases: the shift of work case. The paradigm for this third category is *NLRB v. Burns International Security Services*.³⁷ In that case, the

36. *Esmark, Inc. v. NLRB*, 887 F.2d 739 (7th Cir. 1989), discusses the differences at length. The decision makes clear that the surviving firm in a stock sale is not considered a "successor" under labor law: "The successorship doctrine is simply inapplicable to a stock sale transaction. . . . 'The stock sale involves no break or hiatus between two legal entities, but is, rather, the continuing existence of a legal entity, albeit under new ownership.'" 887 F.2d at 751 (quoting *TKB Int'l. Corp.*, 240 N.L.R.B. 1082, 1083 n.4 (1979)). Instead, "[t]he successorship doctrine is limited to situations in which the predecessor and successor are unrelated entities and the new employer does not assume the contractual obligations of the prior employer." 887 F.2d at 750.

37. 406 U.S. 272 (1972).

Supreme Court imposed a duty to bargain on Burns when, after displacing its competitor Wackenhut in a security contract with Lockheed, Burns hired many of the Wackenhut employees but did not buy any assets from or merge with Wackenhut.

The second major distinction in labor law is the distinction between rights deriving from a collective bargaining agreement (CBA) and rights deriving from the National Labor Relations Act (NLRA). Procedurally, parties litigate claims arising out of the CBA under section 301 of the Labor Management Relations Act (LMRA),³⁸ usually in a proceeding in which an arbitrator interprets the CBA. Parties litigate claims deriving from the NLRA as unfair labor practice claims; the National Labor Relations Board adjudicates those claims, subject to appellate review. Substantively, the distinction between rights under the CBA and rights under the NLRA tracks other common and important distinctions: between cases that arise during the term of a CBA and those that arise after it has expired;³⁹ and between cases that interpret the outcome of the bargaining process and cases involving the bargaining process itself. Labor law successorship doctrine, like the analogous corporate law doctrine, can usefully be categorized and clarified in a matrix incorporating these distinctions:

38. Labor Management Relations (Taft-Hartley), Pub. L. No. 80-101, Act § 301, 51 Stat. 136, 156 (codified at 29 U.S.C. § 185 (1988)).

39. Cases also can arise in a context in which a bargaining unit has been certified but no agreement has been reached on an initial contract.

TAXONOMY OF LABOR LAW SUCCESSORSHIP DOCTRINE

	Merger/Stock Sale	Sale of Assets	Shift of Work
*****	*****	*****	*****
CBA Claims (LMRA § 301)	(1) Obligations under the CBA automatically carry over; surviving firm stands in the shoes of the disappearing firm. Principal cases: <i>Wiley</i> ; <i>Wiley/Interscience</i> labor arbitration award.	(3) Asset purchaser only assumes specified obligations. The CBA only carries forward when the asset purchaser explicitly or constructively adopts it. Substantial continuity provides significant but rebuttable evidence of constructive adoption. Principal case: <i>Howard Johnson</i> .	(5) <i>Burns</i> -type successor not obligated under predecessor's CBA, unless adopted. Principal case: <i>Burns</i> .
*****	*****	*****	*****
NLRA Claims	(2) Obligations under NLRA automatically carry over, both with respect to the presumption of continued majority support and the duty to bargain. Principal cases: <i>Esmark</i> ; <i>Spencer Foods</i> ; <i>Miami Foundry</i> ; <i>TKB</i> .	(4) The presumption of continued majority support and the duty to bargain carry over when more than 50% of asset purchaser's bargaining unit employees worked for seller. Principal cases: <i>Fall River</i> ; <i>Golden State</i> ; <i>Pittsburgh and Lake Erie R.R. Co. v. Railway Labor Executives Assn.</i>	(6) The presumption of continued majority support and the duty to bargain carry forward to the <i>Burns</i> -type successor when more than 50% of its employees worked for the old firm. Principal case: <i>Burns</i> .
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A. Preliminaries

Two elements play important roles in the labor law successorship doctrines: the "duty to bargain" and the concept of "substantial continuity." Because of their importance, we pause at this point to discuss them in greater detail.

1. The Duty To Bargain

The duty to bargain plays a central role in the NLRA system. Under sections 8(a)(5) and 8(b)(3), it is an unfair labor practice for an employer or a union "to refuse to bargain collectively."⁴⁰ Section 8(d) defines collective bargaining as "the performance of the mutual obliga-

40. Labor Management Relations (Wagner) Act, Pub. L. No. 80-101, 61 Stat. 136, 141 (codified at 29 U.S.C. §§ 158(a)(5), 158(b)(3) (1988)).

tion of the employer and the representative of the employees to meet at reasonable times and confer in good faith with respect to wages, hours, and other terms and conditions of employment."⁴¹ While the parties have an obligation to meet and confer in good faith, that obligation "does not compel either party to agree to a proposal or require the making of a concession."⁴²

These vague but critical mandates have given rise to an extensive and complex jurisprudence.⁴³ On the one hand, the Board and the courts have elaborated on the duty to meet, confer, and negotiate, as well as on the obligation to deal in good faith. On the other hand, they have limited the applicability of the duty to bargain to so-called "mandatory topics," specifically — drawing on the language of section 8(d) — "wages, hours, and other terms and conditions of employment." For most other topics, bargaining is permissive, not mandatory.⁴⁴

The duty to bargain is critical for three reasons in the successorship context. First, it establishes or reestablishes a bargaining relationship between the employer and the union. Without it, the union has to engage in an organizing drive, which is typically very costly and has an uncertain outcome. Second, when the duty to bargain applies, the employer *must* bargain with the union over mandatory topics, risking an economic strike if a contract cannot be signed. Moreover, the new employer may be unable to institute changes unilaterally in mandatory topics without first bargaining to impasse.

Third, the duty to bargain forces the parties to disclose information in certain defined contexts. When, for example, an employer claims that it is financially unable to meet the union's demands, it must corroborate such claims on request.⁴⁵ Indeed, an employer's refusal to supply such information may convert an economic strike into an unfair labor practice strike.⁴⁶ The duty to bargain thus provides the union with a low transaction cost mechanism for reestablishing with the new employer the employee protections that it had achieved with the old employer.

While serving these goals, however, the duty to bargain creates its

41. 29 U.S.C. § 158(d) (1988).

42. 29 U.S.C. § 158(d) (1988).

43. See generally 1 THE DEVELOPING LABOR LAW, *supra* note 1, ch. 13.

44. On the distinction between mandatory and permissive topics, see *id.* ch. 16; see also *First Natl. Maintenance Corp. v. NLRB*, 452 U.S. 666 (1981); *Fibreboard Paper Prods. Corp. v. NLRB*, 379 U.S. 203 (1964); *NLRB v. Borg-Warner Corp.*, 356 U.S. 342 (1958).

45. *NLRB v. Truitt Mfg. Co.*, 351 U.S. 149 (1956); *Sioux City Stockyards*, 293 N.L.R.B. 1 (1989); *Accurate Die Casting Co.*, 292 N.L.R.B. 284 (1989).

46. *NLRB v. Jarm Enters, Inc.*, 785 F.2d 195 (7th Cir. 1986).

own opportunities for strategic behavior. Because the employer may not make unilateral changes even during a strike before negotiations reach an impasse, the duty to bargain provides a mechanism that skillful negotiators may use for delay. By stringing out negotiations with sequential minor concessions, anecdotal evidence suggests that a party may delay impasse, and thereby preserve the status quo, for as much as two years.⁴⁷

The issue relating to the duty to bargain that is central to most of this article is the identification of the circumstances in which the stock purchaser or asset purchaser takes on a duty to bargain with the union that previously represented the workers. When those circumstances exist, the law of mandatory topics fixes the scope of that duty.⁴⁸

2. Substantial Continuity

Critical to the different threads of the labor law successorship doctrines is the concept of substantial continuity. Substantial continuity has two elements: continuity of operations and continuity of workforce. The courts and the Board measure substantial continuity of operations by whether the purchaser has "acquired substantial assets of its predecessor and continued, without interruption or substantial change, the predecessor's business operations."⁴⁹ In measuring

47. The *scope* of the duty to bargain — that is, the determination of which topics are mandatory — thus becomes critical. For an economic analysis of mandatory bargaining topics in the relocation context, see Michael L. Wachter, *The Rule Governing Relocation: The Economic Logic of the Supreme Court Cases* (Apr. 1992) (unpublished manuscript, on file with authors). In developing the scope of mandatory topics, the Court has viewed the NLRA's mandate regarding "wages, hours, and other terms and conditions of employment" as words of limitation. *Fibreboard*, 379 U.S. at 220 (Stewart, J., concurring). Only topics that are "almost exclusively 'an aspect of the relationship' between employer and employee" are mandatory under all circumstances. *First National Maintenance*, 452 U.S. at 677 (quoting *Allied Chem. & Alkali Workers v. Pittsburgh Plate Glass Co.*, 404 U.S. 157, 178 (1971)). Issues involving questions of corporate finance, product design, advertising, and the like are always nonmandatory. A third category of issues — those that affect employment but also concern the "scope and direction of the enterprise" — are subject to a balancing test that weighs the benefits and costs of making a subject mandatory. *First National Maintenance*, 452 U.S. at 677.

48. There is a related issue on which we will spend little time, namely, whether the old firm has a duty to bargain with the union over an owner's decision to sell its stock or a firm's decision to sell its assets. This question goes to the obligations of the old firm, as distinguished from our focus on the obligations of the new firm.

Doctrinally, the answer is fairly clear. In general, the old firm has no obligation to bargain over *whether* to sell the firm or its assets, but it does have an obligation to bargain over the *effects* of such a decision on the employees. *First National Maintenance*, 452 U.S. at 677 n.15. On the other hand, bargaining *would* be required if the union proposed increased employment security in the form of a "successor and assigns" clause during negotiations over a new contract when no offer was outstanding. Because such a provision may give the union a right to an injunction against a sale to a purchaser who does not agree to be bound by the old collective bargaining agreement (CBA), see *Howard Johnson Co. v. Detroit Local Joint Executive Bd.*, 417 U.S. 249, 258 n.3 (1973), it can force a predecessor firm to bargain with the union about a future sale of stock or assets.

49. *Golden State Bottling Co. v. NLRB*, 414 U.S. 168, 184 (1973).

substantial continuity of operations, the NLRB examines a number of factors. These include:

whether the business of both employers is essentially the same; whether the employees of the new company are doing the same jobs in the same working conditions under the same supervisors; and whether the new entity has the same production process, produces the same products, and basically has the same body of customers.⁵⁰

Substantial continuity of workforce depends on what proportion of the new employer's workforce was employed by the old employer.⁵¹

In the labor economics literature, the substantial continuity test closely parallels the situations in which the internal labor market is unchanged.⁵² John Dunlop, and later Peter Doeringer and Michael Piore, used these factors to define the internal labor market of the firm as "an administrative unit . . . within which the pricing and allocation of labor is governed by a set of administrative rules and procedures."⁵³ Similarly, Michael Wachter and Randall Wright rely on these factors in defining the internal labor market as the long-term contractual relationship between a firm and its employees with match-specific investments.⁵⁴ This link between substantial continuity and the internal labor market is critical to understanding labor law successorship doctrine.

B. Column 1: Mergers and Stock Sales

1. Box 1: Obligations Under the CBA After a Merger or Stock Sale

As in the corporate context, a merger or stock sale does not, by itself, change any obligation under a CBA. The seminal labor law successorship case, *John Wiley & Sons, Inc. v. Livingston*,⁵⁵ involved a statutory merger. Interscience merged into Wiley, and the much larger Wiley workforce absorbed the Interscience employees. When

50. *Fall River Dyeing & Finishing Corp. v. NLRB*, 482 U.S. 27, 43 (1987).

51. A threshold question is whether the changes resulting from the capital market transaction have affected the "appropriateness" of the bargaining unit. In making its bargaining-unit determination, the NLRB looks to a "community of interest" among the workers. The factors in defining a community of interest include, for example, the similarity in the method of determining compensation; the similarity in benefits, hours, or other terms and conditions of employment; and common supervision and determination of labor-relations policy. ARCHIBALD COX, DEREK BOK, & ROBERT GUSMAN, *LABOR LAW: CASES AND MATERIALS* 283 (10th ed. 1986).

52. For a discussion of continuity of operations, see *infra* text accompanying note 130.

53. PETER B. DOERINGER & MICHAEL J. PIORE, *INTERNAL LABOR MARKETS AND MAN-POWER ANALYSIS* 1-2 (1971) (citing John T. Dunlop, *Job Vacancy Measures and Economic Analysis*, in NATIONAL BUREAU OF ECON. RESEARCH, *THE MEASUREMENT AND INTERPRETATION OF JOB VACANCIES: A CONFERENCE REPORT* 27 (1966)).

54. Michael L. Wachter & Randall D. Wright, *The Economics of Internal Labor Markets*, 29 *INDUSTRIAL REL.* 240 (1990).

55. 376 U.S. 543 (1964).

Wiley refused to recognize the union as the bargaining agent of Interscience's employees, the union brought an action under section 301 of the LMRA to compel arbitration under the arbitration provision of the collective bargaining agreement.⁵⁶ The union sought to require Wiley to recognize rights of former Interscience employees which had vested under the now-lapsed Interscience CBA — specifically, rights to seniority, vacation pay, pension payments, and severance pay.⁵⁷ Wiley argued that "it never was a party to the collective bargaining agreement, and that, in any event, the Union lost its status as representative of the former Interscience employees when they were mingled in a larger Wiley unit of employees."⁵⁸

The Supreme Court held that the Interscience arbitration clause bound Wiley to arbitrate the employees' claims under the Interscience CBA, reasoning that, under state corporate law, the surviving corporation in a merger is generally liable for the obligations of the disappearing firm.⁵⁹ The Court, however, refused to decide whether the union lost its status as representative of the former Interscience employees.⁶⁰

In the subsequent arbitration, the arbitrator determined that, while the Interscience CBA initially continued in full force after the merger, it was displaced once the intermingling rendered the CBA inapplicable.⁶¹

The logic of the *Wiley* rule thus follows the corporate law rule: the surviving firm or the stock purchaser has no greater or lesser obligation to abide by the CBA than the old firm. In *either* situation, a change of circumstances, sometimes initiated by the employer, may render the CBA inapplicable. Whether there is substantial continuity in the operations of the surviving firm provides evidence on the question whether the changes in the operations are so significant as to render the CBA inapplicable.⁶²

56. 376 U.S. at 544-45.

57. 376 U.S. at 552.

58. 376 U.S. at 547.

59. 376 U.S. at 550 n.3. In addition, the Court supported its holding by referring to the federal policy favoring arbitration and the extent to which requiring arbitration will ease the transition for employees, thereby promoting labor peace. For a discussion of the procedural aspects of *Wiley*, see Alan Schwartz, Note, *Procedural Arbitrability Under Section 301 of the LMRA*, 73 YALE L.J. 1459 (1964).

60. 376 U.S. at 547-48.

61. Interscience Encyclopedia, Inc., 55 Lab. Arb. Rep. (BNA) 210, 218 (1970) (Roberts, Arb.).

62. See, e.g., 55 Lab. Arb. Rep. at 218. The Fourth Circuit has commented:

Although we find the collective bargaining agreement was binding [in the case at hand], we do not adopt a rule that labor agreements remain in force in every situation where corporate ownership changes through a stock sale. . . . Where the corporate form survives only in

Wiley was still obligated for all payments due its employees under the CBA, including vacation pay accrued between the date of the merger and the apparently permissible displacement of the CBA, as well as job security, grievance, and seniority provisions during the same period. The arbitrator also held that Wiley was obligated to contribute to the welfare and pension funds under the Interscience CBA, but that the Interscience union had settled those claims.

Although the central issue in the case was one of contract enforcement, it bears important similarities to the statutory issue of the duty to bargain. The CBA continues in effect as long as sufficient continuity exists to make the CBA applicable. A bargaining unit will remain intact after an asset or stock sale as long as substantial continuity exists between the old firm's and the surviving firm's workers. Subsequent cases have largely conformed to this rule.⁶³

name, but an entirely new operation replaces the old, the corporation might not be fairly termed a "continuing" employer in any practical sense.

EPE, Inc. v. NLRB, 845 F.2d 483, 490 (4th Cir. 1988). As previously discussed, we interpret this primarily to be a statement about the nature of the employer's obligation under a CBA, not a statement about whether a merger or sale of stock changes those obligations. Both before and after a merger or stock sale, when "an entirely new operation replaces the old" the old CBA is inapplicable.

63. In *NLRB v. Rockwood Energy & Mineral Corp.*, 942 F.2d 169 (3d Cir. 1991), Harmony Mining Co. signed a CBA effective through September, 1984. In 1982, Harmony suspended production because of financial difficulties. REMCO, Harmony's major creditor, acquired control by acquiring all of the Harmony stock and then sought to repudiate all obligations under the CBA. Ultimately, REMCO reopened production but unilaterally changed terms. The Third Circuit held that, because REMCO acquired control through a stock sale, it stood in Harmony's shoes and thus could not unilaterally change terms of the CBA. Similarly, in *Esmark, Inc. v. NLRB*, 887 F.2d 739 (7th Cir. 1989), the Seventh Circuit found that the CBA agreement continued to apply following transfer of a firm's ownership through a sale of its stock. See also *EPE, Inc. v. NLRB*, 845 F.2d 483 (4th Cir. 1988) (holding that CBA remains in force after stock sale); *General Teamsters Local Union No. 249 v. Bill's Trucking, Inc.*, 493 F.2d 956 (3d Cir. 1974) (enforcing CBA when only the identity of stockholders and corporate name change); *Phillip Wall & Sons, Inc.*, 287 N.L.R.B. 1161 (1988); *Lauer's Furniture Stores, Inc.*, 246 N.L.R.B. 360 (1979); *TKB Intl. Corp.*, 240 N.L.R.B. 1082 (1979) (holding that, when TKB acquired Hendricks-Miller by a stock transfer, TKB remained a member of the multiemployer bargaining unit, with all the associated obligations, until withdrawal pursuant to the withdrawal requirements); *Topinka's Country House, Inc.*, 235 N.L.R.B. 72 (1978); *Western Boot & Shoe, Inc.*, 205 N.L.R.B. 999 (1973). But see *NLRB v. Edjo, Inc.*, 631 F.2d 604, 608 (9th Cir. 1980) (holding that existing collective bargaining agreement does not bind a stock purchaser, although stock purchaser also may not unilaterally set initial terms). Apparently neither party in *Edjo* argued that the stock purchaser was obligated to abide by the seller's CBA. 631 F.2d at 606 n.3. One of the judges, however, concurred in the result on this ground. 631 F.2d at 608-09 (Blumenfeld, J., concurring).

In *MPE, Inc.*, 226 N.L.R.B. 519 (1976), the Board held that a stock purchaser, unaware that the old management had negotiated and initialed — but not yet formally executed — a new CBA, was not bound by it. However, the Board did not determine whether the old employer, having initialed the agreement, would have been obligated to execute it but for the sale. The Board itself seems to recognize the extent to which *MPE* departs from the general approach to Box 1 cases. In a subsequent case, the Board sought to distinguish *MPE* as "a situation where the stock transfer occurs at a time when no contract exists to be assumed," without acknowledging that the parties had negotiated and initialed a CBA prior to the transfer of the stock. 240 N.L.R.B. at 1085.

2. *Box 2: Obligations Under the NLRA After a Merger or Stock Sale*

In contrast to Box 1 cases, which typically arise during the term of a CBA, most Box 2 cases arise when control of the firm changes after the CBA has lapsed or prior to the signing of an initial contract. Because there is no continuing CBA, no section 301 issues arise. Instead, Box 2 cases hinge upon whether the surviving firm has a statutory duty to bargain with its workforce. Again showing the parallels between corporate and labor law, the rules of Box 2 largely follow those of Box 1. Labor law assumes that the firm resulting from a merger or a stock sale retains its identity and thus has the same duty to bargain as the old firm.⁶⁴

This duty to bargain, however, continues only as long as the union continues to represent the employees in the bargaining unit. In Box 2-type cases, the duty to bargain in good faith is a presumptive rather than absolute obligation. In the year following Board certification and during the term of a CBA, the union enjoys an irrebuttable presumption of continuing majority support;⁶⁵ subsequently that presumption becomes rebuttable.⁶⁶ An employer may withdraw recognition and stop bargaining if it can establish either that the union no longer enjoys the support of a majority of the bargaining unit employees or that its refusal to bargain is based on a good faith, reasonable doubt of continued majority support, based on objective considerations.⁶⁷ A merger or stock sale does not disturb these presumptions.⁶⁸ The burden remains with the firm to rebut the presumption of continued majority status.

Thus, in *United Food & Commercial Workers International Union v. NLRB*⁶⁹ (*Spencer Foods*), Land O'Lakes acquired Spencer Foods by acquiring all of its stock after the CBA had lapsed, the plants had been shut down, and the workers had been laid off. The D.C. Circuit found no substantial evidence in the record to support the Board's conclu-

64. See *United Food & Commercial Workers Intl. Union v. NLRB*, 768 F.2d 1463, 1470-71 (D.C. Cir. 1985).

65. *Fall River Dyeing & Finishing Corp. v. NLRB*, 482 U.S. 27, 37-39 (1987); *NLRB v. Burns Intl. Sec. Servs., Inc.*, 406 U.S. 272, 279 n.3 (1972); *Brooks v. NLRB*, 348 U.S. 96 (1954); *Rockwood Energy*, 942 F.2d at 173; see also 1 *THE DEVELOPING LABOR LAW*, *supra* note 1, at 572.

66. *Rockwood Energy*, 942 F.2d at 173.

67. *Fall River*, 482 U.S. at 41 n.8; *NLRB v. Phoenix Pipe & Tube, L.P.*, 955 F.2d 852, 857 (3d Cir. 1991); see also 1 *THE DEVELOPING LABOR LAW*, *supra* note 1, at 571 (citing cases).

68. *NLRB v. Edjo, Inc.*, 631 F.2d 604, 607 (9th Cir. 1980) (holding that a change of stock ownership does not alter the presumptions regarding continued majority support and duty to bargain).

69. 768 F.2d 1463 (D.C. Cir. 1985).

sion that the new Spencer Foods — that is, the firm now owned by Land O'Lakes — justifiably refused to bargain with the union, and the court remanded the case to the Board to fashion a remedy.

Spencer Foods illustrates the role that substantial continuity plays in Box 2 cases — that is, cases involving a successor firm's duty to bargain after a merger or stock sale. Substantial continuity is irrelevant to whether the old firm's duty to bargain carries forward to the new firm or owners. Substantial continuity, however, is critical to determining whether the new firm can rebut the presumption of continued majority support that exists even after a CBA has expired. Lack of substantial continuity can establish either lack of majority support or a good faith and reasonable belief based on objective considerations that the union no longer enjoys majority support in the relevant bargaining unit. In *Spencer Foods*, the Court held that, given the substantial continuity that existed between the old and new firms, the new firm had not rebutted the presumption that the union enjoyed majority support in the workforce, and therefore the firm was obligated to bargain collectively. The court's holding rested on the administrative law judge's finding that the layoffs probably would be temporary, serving to "effectuate a sale of an ongoing business enterprise to [Land O'Lakes], i.e., a business which encompassed the resumed operations of the Spencer plant by [Spencer Foods] albeit under new ownership."⁷⁰

C. Column 2: Sale of Assets

Boxes 3 and 4 concern transactions between the old firm and the surviving firm that involve a sale of assets. Recall that, under the corporate law rule, a purchaser of assets does not assume the claims of known claimants in tort or contract unless specifically agreed. On the other hand, with respect to long-tail tort claimants, corporate law has developed legal mechanisms to limit opportunistic behavior. The labor law cases follow the same pattern with a different spin.

70. 768 F.2d at 1472 (quoting *Spencer Foods, Inc.*, 268 N.L.R.B. 1483, 1509 (1984)). But for a contrasting case, see *NLRB v. Rockwood Energy & Mineral Corp.*, 942 F.2d 169 (3d Cir. 1991). In *Rockwood Energy*, the court correctly held that substantial continuity was irrelevant to whether the duty to bargain remained after a stock sale. However, the court virtually ignored the importance of substantial continuity to the determination whether the employer had carried its burden of establishing that the union no longer enjoyed majority support after a five-year hiatus. See, e.g., *Miami Foundry Corp. v. NLRB*, 682 F.2d 587 (6th Cir. 1982); *Miller Trucking Serv., Inc.*, 176 N.L.R.B. 556 (1969), *enforcement denied on other grounds*, 445 F.2d 927 (10th Cir. 1971).

1. *Box 3: Obligations Under the CBA After an Asset Sale*

*Howard Johnson Co. v. Detroit Local Joint Executive Board*⁷¹ involved the obligations of the purchaser of assets under the seller's collective bargaining agreement. Originally, the Grissoms operated a Howard Johnson franchise motel and adjacent restaurant. The employees, represented by a union, had entered into a CBA with the Grissoms containing an arbitration provision. Howard Johnson subsequently leased the premises, hiring only a few of the Grissom employees. The union brought an action against Howard Johnson under section 301 of the LMRA to enforce rights of employees not hired by Howard Johnson. The Grissoms had agreed to arbitrate the extent of their liability to the former employees under the CBA.⁷²

The Court held that Howard Johnson was not obligated under the CBA between the former employees and the Grissoms.⁷³ The Court distinguished *Wiley*, on which the union principally relied, on the grounds that *Wiley* had involved a merger; in contrast, *Howard Johnson* involved a sale of assets, after which the Grissoms — the initial employers — remained a viable corporate entity against whom the union could enforce any obligations under the CBA.⁷⁴ Indeed, even though the CBA with the Grissoms contained a "successors and assigns clause" — purporting to make the agreement binding on any successors and assigns — the Court held that the clause could not bind a nonconsenting party but perhaps could have permitted the union to enjoin the lease to Howard Johnson as a breach of the clause.⁷⁵

The rule of *Howard Johnson*, like the analogous corporate law rule, is thus that, when a firm acquires assets, it does not assume the seller's contractual obligations, specifically its collective bargaining agreement, unless it agrees to adopt it.⁷⁶ The Court noted that this rule was consistent with federal labor law, which imposes no "official compulsion" to sign a contract or to adopt any specific contractual terms.⁷⁷ As the primary justification for this rule, the Court invoked a corporate law goal of free capital mobility: "holding a new employer bound by the substantive terms of the pre-existing collective-bargaining agreement might inhibit the free transfer of capital."⁷⁸ As a logical

71. 417 U.S. 249 (1974).

72. 417 U.S. at 255.

73. 417 U.S. at 264-65.

74. 417 U.S. at 257.

75. 417 U.S. at 258 n.3.

76. See also *Fall River Dyeing & Finishing Corp. v. NLRB*, 482 U.S. 27 (1987).

77. *Howard Johnson*, 417 U.S. at 254.

78. 417 U.S. at 255 (explaining *NLRB v. Burns Int'l. Sec. Servs., Inc.*, 406 U.S. 272, 287-88).

extension of this reasoning, the Court also reached the central holding that Howard Johnson had no duty to hire the predecessor's employees.⁷⁹

2. *Box 4: Obligations Under the NLRA After an Asset Sale*

Just as Box 4 of the corporate law matrix proves to be the most complicated and difficult because of the potential for strategic behavior, so too does Box 4 of the labor law matrix. The principal Box 4 issue is whether an asset purchaser has a duty to bargain with the union that represented the employees of the seller.⁸⁰

In *Fall River Dyeing & Finishing Corp. v. NLRB*,⁸¹ the Supreme Court held that, when substantial continuity exists between the business of the asset seller and purchaser, the asset purchaser has a duty to bargain with the seller's union if "the majority of its employees were employed by its predecessor."⁸² Because the successor has no duty to hire the predecessor's employees, however, the Court concluded that triggering the duty to bargain "rests in the hands of the successor."⁸³

The courts have made it clear that an asset purchaser cannot avoid a duty to bargain by discriminating against employees of the seller because of their union status.⁸⁴ What counts as antiunion animus in the failure to hire employees of the asset seller has been litigated extensively.⁸⁵ Critical factors that suggest antiunion animus include:

(1972)). Beyond this, the Court offers no argument for why it should not deem an asset purchaser to have consented to the successor and assigns clause. By contrast, our analysis provides an explanation.

79. 417 U.S. at 264.

80. A secondary issue is whether an asset purchaser is liable for the asset seller's unfair labor practices. The Supreme Court held in *Golden State Bottling Co. v. NLRB*, 414 U.S. 168 (1973), that a purchaser who bought with knowledge of the seller's unfair labor practices is jointly and severally liable. This holding departs from the background corporate law rule, under which the asset purchaser is normally not liable for the obligations of the seller. The courts subsequently have held that the asset purchaser is liable when it had notice of unfair labor practice charges by the union, even though formal charges had not been filed. *NLRB v. General Wood Preserving Co.*, 905 F.2d 803 (4th Cir.), cert. denied, 498 U.S. 1016 (1990).

81. 482 U.S. 27 (1987).

82. 482 U.S. at 41. *Fall River* did not resolve the ambiguity in prior cases with respect to whether the duty to bargain attaches if the asset purchaser hires a majority of the seller's represented employees but those employees do not constitute a majority of the employees of the purchaser, 482 U.S. at 46 n.12. The Board, supported by the courts of appeal, has held that workforce continuity only exists if a majority of the asset purchaser's employees were employed by the seller. *Saks & Co. v. NLRB*, 634 F.2d 681, 684-86 & nn.2-3 (2d Cir. 1980) (citing relevant cases); *Spruce Up Corp.*, 209 N.L.R.B. 194, 196 (1974), enforced, 529 F.2d 516 (4th Cir. 1975); *United Maintenance & Mfg. Co.*, 214 N.L.R.B. 529, 532-34 (1974).

83. *Fall River*, 482 U.S. at 41.

84. 482 U.S. at 39-40; *Howard Johnson Co. v. Detroit Local Joint Executive Bd.*, 417 U.S. 249, 262 n.8 (1974); *Elastic Stop Nut v. NLRB*, 921 F.2d 1275 (D.C. Cir. 1990).

85. See generally the cases cited in 1 *THE DEVELOPING LABOR LAW*, *supra* note 1, at 797 nn.168 & 170. *United Food & Commercial Workers Intl. Union v. NLRB*, 768 F.2d 1463, 1470-

efforts by the new employer to discover from the old employer the union sympathies of its employees, followed by a refusal to hire those identified as sympathetic; hiring criteria with a disparate impact; and an overall scheme designed to ensure that fewer than a majority of the employees are union members. Factors inconsistent with animus include unsuitability for new employer's operations and uniformly applied, valid business reasons for hiring a totally inexperienced workforce. In aggregate, these factors suggest that, if a new employer maintains the old operations intact, hiring new, inexperienced, nonunion employees in preference to experienced, union employees indicates antiunion animus.⁸⁶ By contrast, if operations substantially are changed so that experience in the old operation would be of little value in the new operation, no such inference is warranted.

In these cases, the critical issue is whether the union or the firm has the burden of establishing majority support or its absence. In an asset sale, when substantial continuity of operations and workforce exists, the firm must establish lack of support if it does not wish to bargain collectively. This obligation is precisely the same duty as the old firm has after a CBA has lapsed.⁸⁷ When, on the other hand, there is no substantial continuity in the workforce, the union has its normal burden of establishing majority support before the firm has a duty to bargain collectively.⁸⁸

Although many labor law scholars argue that successorship rules provide scant protection to unions, Box 4 of our labor law taxonomy shows that employees receive substantially *greater* protection than corporate law gives creditors generally. The fundamental goal of corporate law successorship doctrine, as noted above,⁸⁹ is to place creditors in the same position vis-à-vis the successor as they were vis-à-vis the predecessor with respect to their contractual entitlements. If creditors

71 (D.C. Cir. 1985) [hereinafter *Spencer Foods*] provides one case in point. In *Spencer Foods*, the court found an asset purchaser to have discriminated against the union when it adopted a hiring standard which disqualified many former union members from consideration for reemployment but did not apply the standard uniformly in comparable situations. 768 F.2d at 1474-76. By way of contrast, in *Inland Container Corp.*, 267 N.L.R.B. 1187 (1983), modified by 273 N.L.R.B. 1856 (1985); 274 N.L.R.B. 887 (1985); 275 N.L.R.B. 378 (1985), *Inland* claimed that it refused to hire the predecessor's workers because, having not been trained in the "Inland Way," they had formed "bad habits." When the record showed that *Inland* applied this rule in comparable situations, the Board found no antiunion animus. 267 N.L.R.B. at 1190. Subsequent evidence that *Inland* only hired applicants willing to work in a nonunion environment, however, led the Board to reverse this finding. See 275 N.L.R.B. at 382-88.

86. See, e.g., *United States Marine Corp. v. NLRB*, 944 F.2d 1305, 1315-17 (7th Cir. 1991), cert. denied, 112 S. Ct. 1474 (1992); *Spencer Foods*, 768 F.2d at 1474-76.

87. See *supra* notes 64-70 and accompanying text.

88. See 1 THE DEVELOPING LABOR LAW, *supra* note 1, at 562-63.

89. See *supra* text accompanying notes 12-16.

are no worse off after a sale of assets than they were before, they have no grounds for complaint. Thus, if a financially weak firm sells all or substantially all its assets for fair value, creditors are no worse off and known creditors have no claim against the asset purchaser.

Labor law provides the corporate law protection of employees as creditors so routinely that courts and commentators have largely ignored it. If the asset seller owes the employees wages, the employees can recover those wages from the seller. But, in striking contrast to the corporate law successorship doctrine with its focus on controlling behavior of the predecessor, labor law successorship doctrine also focuses on the behavior of the asset purchaser. Over and above the creditor protections afforded by corporate law successorship doctrine and other creditor protective measures — for example, fraudulent conveyance and bulk transfer restrictions — labor law provides that, when an asset purchaser maintains substantial continuity with the asset seller by hiring a majority of the seller's employees, the asset purchaser has a duty to bargain collectively. We will argue that the employees' distinctive relationship with the firm best explains this difference.⁹⁰

3. *Constructive Adoption of the CBA and Setting Initial Terms After an Asset Purchase*

In distinguishing *Howard Johnson* from *Wiley*, the Court relied on the form of the transaction, that is, on the fact that *Howard Johnson* involved an asset sale rather than a merger.⁹¹ The Court's reliance on this corporate law distinction supports our claim that the corporate taxonomy provides a useful basis for a positive theory of labor law successorship doctrine. Under this taxonomy, structuring a transaction as an asset sale rather than a merger results in different obligations in both corporate and labor law. To that extent, locating the boundary between Box 3 and Box 1 with respect to CBA claims, and between Box 4 and Box 2 with respect to the duty to bargain, becomes critical.⁹²

The boundary question most clearly arises when the asset purchaser hires all the seller's workers to do the same work as they were doing before. Had a merger occurred, *Wiley* makes it clear that the old CBA would fully bind the new firm.⁹³ In such circumstances, the new firm must continue the terms of the old CBA and, subsequently, will be obligated to bargain over wages, hours, or terms and conditions

90. See *infra* Part IV.

91. *Howard Johnson Co. v. Detroit Local Joint Executive Bd.*, 417 U.S. 249, 256 (1974).

92. For the analogous issue in corporate law, see *supra* text accompanying notes 18-35.

93. *John Wiley & Sons, Inc. v. Livingston*, 376 U.S. 543, 551 (1964).

of employment to impasse before making unilateral changes. When a sale of assets occurs, by contrast, *Howard Johnson* makes it clear that the asset purchaser is not bound by the seller's CBA unless it agrees to adopt it.⁹⁴ Similarly, *Fall River* makes clear that, when substantial continuity of workforce and operations exists, the asset purchaser will assume a duty to bargain.⁹⁵

In this boundary case, however, when the asset purchaser hires all the old employees to do the same work as they were doing before, does the CBA carry forward to the lesser degree that the asset purchaser must continue its terms while bargaining over any changes from the old CBA, a process that can drag out for a long time? Although this situation provides the same general temptation to argue that "form" should not be elevated over "substance,"⁹⁶ the doctrine has pursued a different path. In dictum in the *Burns* case, the Court suggested that in *some* circumstances the old CBA would carry forward in setting the initial terms:

Although a successor employer is ordinarily free to set initial terms on which it will hire the employees of a predecessor, there will be instances in which it is perfectly clear that the new employer plans to retain all of the employees in the unit and in which it will be appropriate to have him initially consult with the employees' bargaining representative before he fixes terms.⁹⁷

The Court thus left open room for a limited exception to the general rule that the predecessor's CBA does not bind the successor.

In the *Spruce Up* doctrine,⁹⁸ the Board has elaborated on the

94. 417 U.S. 249, 262, 264-65.

95. *Fall River Dyeing & Finishing Corp. v. NLRB*, 482 U.S. 27, 46 (1987).

96. See, e.g., *United States Gypsum Co. v. United Steelworkers*, 384 F.2d 38 (5th Cir. 1967), *cert. denied*, 389 U.S. 1042 (1968). In that case, U.S. Gypsum purchased all property and assets of a United Cement plant and continued the operations unchanged. Initially, the Fifth Circuit held that Gypsum was bound by the arbitration provision of United Cement's CBA, despite the fact that it merely acquired the assets and that the purchase agreement undertook to exclude the CBA from the purchase. 384 F.2d at 41-44. The Fifth Circuit revisited the question in a second, post-*Burns* opinion. There, the Fifth Circuit held that, despite *Burns*, the arbitrator was not barred from ordering that Gypsum comply with the terms of the United Cement contract. The court relied heavily on the Sixth Circuit's opinion in the *Howard Johnson* case, which imposed the terms of the old employer CBA in a case in which the new employer had not retained the old employees. *United Steelworkers v. United States Gypsum Co.*, 492 F.2d 713 (5th Cir.), *cert. denied*, 419 U.S. 998 (1974). Finally, in its third *Gypsum* opinion, the Fifth Circuit held that the Supreme Court's reversal of *Howard Johnson* did not change its own conclusion because, unlike *Howard Johnson*, *Gypsum* involved substantial continuity of the workforce. *United Steelworkers v. United States Gypsum Co.*, 498 F.2d 334 (5th Cir.), *cert. denied*, 419 U.S. 998 (1974). The Fifth Circuit's holding is clearly no longer good law; *Fall River* made it clear that an asset purchaser who explicitly rejects the old CBA up front is not bound by it, no matter how much continuity exists in the workforce.

97. *NLRB v. Burns Intl. Sec. Servs., Inc.*, 406 U.S. 272, 294-95 (1972).

98. The doctrine is named after the leading Board decision, *Spruce Up Corp.*, 209 N.L.R.B. 194 (1974), *enforced*, 529 F.2d 516 (4th Cir. 1975). See generally 1 THE DEVELOPING LABOR LAW, *supra* note 1, at 814-16. In *Spruce Up*, the new employer displaced the old employer in the

Supreme Court's caveat, defining the circumstance under which an asset purchaser must bargain over initial terms. The scope of the *Spruce Up* doctrine is important in analyzing the success of our taxonomy. A broad scope for the doctrine would result in treating many asset sales similarly to stock sales.

Consistent with the corporate law approach to the obligations of asset purchasers, however, the doctrine restricts the *Burns* caveat to those situations in which an agreement to continue the CBA can be implied. In particular, the caveat applies to (1) "circumstances in which the new employer has either actively or, by tacit inference, misled employees into believing they would all be retained without change in their wages, hours, or conditions of employment"; or (2) "to circumstances where the new employer . . . has failed to clearly announce its intent to establish a new set of conditions prior to inviting former employees to accept employment."⁹⁹ The courts of appeals have largely followed the Board's *Spruce Up* interpretation.¹⁰⁰

Spruce Up barber shop concession at Fort Bragg. Prior to taking over the concession, the new employer, Fowler, refused to recognize or bargain with the old union but told the union representatives that "all the barbers who are working will work." He also informed them of the commission rates he intended to pay, which were significantly below what the barbers had been earning from the previous concessionaire. The union alleged that Fowler had committed unfair labor practices by refusing to bargain and by unilaterally changing the commission rates. Ultimately, more than half of the barbers in the new *Spruce Up* shops had worked for the old concessionaire. 209 N.L.R.B. at 194-95. The case thus presented the question of the scope of the *Burns* caveat: Is the new employer who expresses a willingness or an intention to hire the old employees free to set initial terms, or must it abide by the old CBA until it negotiates a new agreement or bargains to impasse?

99. 209 N.L.R.B. at 195. As examples of cases that fall within the *Burns* caveat, the Board cited two prior opinions "where the successor-employers, without prior warning, unilaterally changed the terms and conditions of employment prevailing under the predecessor after already having committed themselves to hire almost all of the old unit employees with no notice that they would be expected to work under new and different terms." 209 N.L.R.B. at 195 n.7 (citing *Howard Johnson Co.*, 198 N.L.R.B. 763 (1972), *aff'd.*, 496 F.2d 532 (9th Cir. 1974); *Good Foods Mfg. & Processing Corp.*, 200 N.L.R.B. 623 (1972), *aff'd.*, 492 F.2d 1302 (7th Cir. 1974)).

100. See, e.g., *Brotherhood of Ry. v. REA Express, Inc.*, 523 F.2d 164 (2d Cir.), *cert. denied*, 423 U.S. 1017 (1975). The court stated:

We read [the *Burns* caveat] as being limited to those situations where employees are led at the outset by the successor-employer to believe that they will have continuity of employment on pre-existing terms and as not applying where the new employer dispels any such impression prior to or simultaneously with its offer to employ the predecessor's work force.

523 F.2d at 171; see also *United States Marine Corp. v. NLRB*, 944 F.2d 1305, 1321-22 (7th Cir. 1991) (holding that new employer cannot create ambiguity about its plan to hire old employees through illegal activity), *cert. denied*, 112 S. Ct. 1474 (1992); *Saks & Co. v. NLRB*, 634 F.2d 681, 687 (2d Cir. 1980) (finding that new employer did not lead employees to believe preexisting terms would continue and was free to change terms); *Bellingham Frozen Foods v. NLRB*, 626 F.2d 674, 680 (9th Cir. 1980) (holding that new employer who maintained previous working conditions for a week after takeover could not unilaterally change terms), *cert. denied*, 449 U.S. 1125 (1981); *Nazareth Regional High Sch. v. NLRB*, 549 F.2d 873, 881 (2d Cir. 1977) (holding that new employer may fix initial terms when it does not explicitly state an intention to hire old employees on preexisting terms); *Spitzer Akron, Inc. v. NLRB*, 540 F.2d 841, 845 (6th Cir. 1976) (holding that new employer who hires all the old employees and tells them that the company would "carry on as usual" cannot subsequently institute unilateral changes), *cert. denied*, 429

The *Burns* caveat, as developed in the Board's *Spruce Up* doctrine, thus imposes an obligation on a new employer to give advance notice if it wants both to hire the old employees and to set initial terms unilaterally. Otherwise, it runs the risk that the Board or a court will find that the new employer either impliedly adopted the old CBA or adopted the old CBA as the initial terms, changes from which will be subject to a mandatory duty to bargain. The question whether the new employer has manifested an intent to be bound by the old CBA will thus be a factual question in which substantial continuity in operations and workforce are relevant but not dispositive considerations.¹⁰¹

D. Column 3: Shift of Work

Labor law's focus on the behavior of the continuing firm yields a third column that emanates from *NLRB v. Burns International Security Services, Inc.*¹⁰² In *Burns*, the old employer, Wackenhut, and the new employer, Burns, had no contractual relationship. Burns did not merge with or purchase any assets from Wackenhut. Rather, Burns displaced Wackenhut in a security contract with Lockheed by making a lower bid. Subsequently, Burns hired many of Wackenhut's former employees. The union that represented the Wackenhut employees alleged that Burns both was bound by the Wackenhut CBA and obligated to bargain collectively under the NLRA. The case thus squarely raised the questions of the new employer's obligations in Box 5 (under the old employer's CBA) and Box 6 (under the NLRA).

1. Box 5: Obligations Under the CBA After a Shift of Work

The Supreme Court held that Burns did not have a duty to observe the substantive terms of the Wackenhut CBA, to which Burns had never agreed.¹⁰³ Box 5 is thus essentially the same as Box 3, which concerns CBAs following a sale of assets: the CBA carries forward only if the new firm adopts it.¹⁰⁴ The Court distinguished the *Wiley*

U.S. 1040 (1977); *Zim's Foodline v. NLRB*, 495 F.2d 1131, 1142-44 (7th Cir.) (finding that new employer who continues old terms for three weeks cannot make changes unilaterally), *cert. denied*, 419 U.S. 838 (1974).

101. See, e.g., *United States Can Co.*, 305 N.L.R.B. 1127 (1992) (holding that new employer adopted its predecessor's CBA), *enforced*, 984 F.2d 864 (7th Cir. 1993).

102. 406 U.S. 272 (1972).

103. 406 U.S. at 291.

104. See also *Auto Mechanics Local Lodge No. 1101 v. NLRB*, 945 F.2d 408 (9th Cir. 1991) (opinion at No. 90-70096, 1991 WL 197005 (Oct. 3, 1991)) (holding that union obligated to bargain with successor employer); *Boeing Co. v. International Assn. of Machinists & Aerospace Workers*, 504 F.2d 307 (5th Cir. 1974) (holding that lack of continuity of work force absolves new employer from duty to arbitrate under old employer's CBA), *cert. denied*, 421 U.S. 913

case (Box 1) on the same corporate law grounds as it used in *Howard Johnson*, namely, that *Wiley* involved a merger occurring against a background of state law that provided that the surviving firm would be liable for the disappearing firm's obligations.¹⁰⁵

2. *Box 6: The Duty To Bargain After a Shift of Work*

With regard to the duty to bargain, the *Burns* Court went on to hold that, because the union had been designated the exclusive bargaining agent in an election a few months before and the new employer had hired a majority of the old employer's employees, the duty to bargain carried forward.¹⁰⁶ Thus, Box 6 parallels Box 4, which concerns the duty to bargain after a sale of assets: in each case, substantial continuity creates a rebuttable presumption of continued majority support.¹⁰⁷ Whether the new firm must bargain over initial terms is, as in Box 3, governed by the *Spruce Up* doctrine.¹⁰⁸ Box 6 is a category completely absent from the corporate successorship doctrine and, like Box 4, gives substantial extra protection to employees over that afforded creditors generally.¹⁰⁹

E. *The Failure of the Supreme Court To Adopt the Taxonomy*

Neither courts nor legal commentators have previously recognized that the corporate law taxonomy carries over more or less intact to labor law. Indeed, it is worth noting that cases are still litigated over

(1975). *But see* *Systems Management, Inc. v. NLRB*, 901 F.2d 297 (3d Cir. 1990). *Systems Management* held that, when antiunion animus led to lack of workforce continuity and refusal to bargain, the injured employees were entitled to back pay at the old rate, although perhaps only until impasse would have been reached. It is unclear, however, whether the court asserted that the old CBA should have set initial terms or whether the court believed that, had the old union been bargaining, the employer would have been willing to pay the old rate.

105. *Burns* (Box 5) does not make clear whether substantial continuity in the workforce creates a rebuttable presumption that the old CBA carries forward absent explicit repudiation. *Burns* told the ex-Wackenhut employees when hired that *Burns* "could not live with" the existing contract between Wackenhut and the union." 406 U.S. at 275. The Court never addressed the question whether an explicit repudiation was necessary or whether this constituted an explicit repudiation.

106. 406 U.S. at 278.

107. *See, e.g., NLRB v. New Medico Health Care Ctr.*, 951 F.2d 350 (6th Cir. 1991) (opinion at No. 91-5271, 1991 WL 276260 (Dec. 20, 1991)) (finding that duty to bargain carries forward when the successor hires virtually all former employees), *cert. denied*, 112 S. Ct. 2965 (1992); *Auto Mechanics Local Lodge No. 1101 v. NLRB*, 945 F.2d 408 (3d Cir. 1991) (holding that duty to bargain carries forward when successor rehires 11 of 13 former employees); *Systems Management*, 901 F.2d 297 (finding that, when antiunion animus prevents the determination of whether a majority of new employees would have been former employees of old firm, firm has a duty to bargain).

108. *See supra* notes 98-101 and accompanying text.

109. As Justice Rehnquist noted in dissent, *Burns* offers labor claimants added protection over nonlabor claimants by divorcing labor claims against a successor from the actual assets the successor acquires. *Burns*, 406 U.S. at 305.

whether Column 1 (mergers and stock purchases) or Column 2 (sale of assets) rules apply, with firms attempting to have Column 2 rules applied to stock purchases, and unions attempting to have Column 1 rules applied to asset purchases.¹¹⁰ The source of the confusion partly derives from the evolution of the Supreme Court cases and the resulting failure of the Supreme Court to recognize the taxonomy and to adopt it explicitly. *Burns* represented the first recognition that the holding in *Wiley* turned on the fact that it was a Column 1 case. But *Burns* involved the atypical shift of work of Column 3 and hence could not clarify the differences between the more typical Column 2 and Column 1 cases. *Golden State Bottling Co.* was the first Supreme Court case involving the purchase of assets, but it involved the narrow issue of whether an asset purchaser, having purchased substantially all of the assets and having hired substantially all of the employees, succeeded to the duty to remedy an unfair labor practice.¹¹¹

Not until *Howard Johnson* did the Court deal with the critical Column 2 issue: whether an asset purchaser succeeded to the CBA. The Court correctly identified the importance of the difference between *Howard Johnson's* asset sale and *Wiley's* stock sale. In its Box 3 ruling, however, the Court planted the seeds of future confusion by stating that "ordinarily there is no basis for distinguishing among mergers, consolidations, or purchases of assets in the analysis of successorship problems."¹¹² This unfortunate comment has led the Board and lower courts into believing, incorrectly, that the distinction between transactions is irrelevant. Finally, the court did not directly resolve the Box 4 question until *Fall River Dyeing* in 1987.¹¹³ Again, the Court correctly used, but did not adopt, the corporate law taxonomy.

Our application of the corporate taxonomy to the labor context, and the continuing evolution of the cases, shows that, despite dicta to the contrary, the form of the transaction does in fact matter.

110. See, e.g., *United States Can Co. v. NLRB*, 984 F.2d 864 (7th Cir. 1993). Oddly, although this was clearly a merger-stock sale case (Column 1), all the parties litigated the case as if it were a sale of assets case (Column 2).

111. The Court held that it did. *Golden State Bottling Co. v. NLRB*, 414 U.S. 168, 180 (1973).

112. *Howard Johnson Co. v. Detroit Local Joint Executive Bd.*, 417 U.S. 249, 257 (1974). The Court noted that it had previously reached the same conclusion in *Golden State*, 414 U.S. at 168. In *Golden State* the Court stated:

The refusal to adopt a mode of analysis requiring the Board to distinguish among mergers, consolidations, and purchases of assets is attributable to the fact that, so long as there is a continuity in the "employing industry," the public policies underlying the doctrine will be served by its broad application.

414 U.S. at 182-83 n.5.

113. *Fall River Dyeing & Finishing Corp. v. NLRB*, 482 U.S. 27 (1987).

Although the Supreme Court has consistently limited its holdings rather than explicitly adopting a corporate taxonomy for the labor context, its decisions are fully consistent with the taxonomy. Moreover, applying the taxonomy to lower court and Board decisions resolves much of the confusion concerning which Supreme Court precedent applies in a given context.¹¹⁴

F. *The Substantial Continuity Thread*

As we have shown, substantial continuity in operations and workforce play important, but fundamentally different, roles in the different boxes of the labor law successorship taxonomy. In Box 1, the question is whether the CBA carries forward after a merger or stock sale. In this area, substantial continuity helps determine whether circumstances have changed so substantially that the CBA can no longer be applied. Circumstances after a stock sale or merger may change sufficiently for an arbitrator to conclude that the CBA is no longer applicable. In Box 2, the key issue is whether the duty to bargain carries forward after a merger or stock sale. In Box 2 cases, substantial continuity helps determine whether the firm can rebut the presumption of continuing majority support of the union. The changes sufficient in Box 1 to render the CBA inapplicable may not, in Box 2, be sufficient to disturb an existing duty to bargain.

In Column 2, substantial continuity works differently. In Box 3, the critical question is whether the CBA carries forward to the asset purchaser. The background rule is that no obligations carry forward, but substantial continuity may create a rebuttable presumption that places a burden on the asset purchaser to establish explicit rejection of the old CBA. In any event, the possibility that the Board or the courts may find constructive adoption in cases of substantial continuity provides an incentive for asset purchasers to reject the old CBA explicitly if they do not wish it to bind them. By contrast, in Box 4, the question is whether the duty to bargain carries forward. In this area, substantial continuity determines whether the firm or the union bears the burden of rebutting or establishing majority support. But, as in Column 1, the extent of continuity sufficient to trigger a duty to bargain in Box 4 will not necessarily trigger a rebuttable presumption in Box 3. Indeed, the *Spruce Up* doctrine demands a great deal before imposing

114. For example, the frequently debated role of *Wiley* becomes clear. Contrary to much of the literature, see sources cited *supra* note 5, the Supreme Court has never overturned or limited *Wiley*. *Wiley* remains today, as when first decided, the case defining the CBA obligations of the stock purchaser (Box 1). See *John Wiley & Sons, Inc. v. Livingston*, 376 U.S. 543 (1964). The error in believing that *Wiley* ever had a broader scope resulted from a failure to recognize that labor law cannot ignore the substantive distinctions that arise from corporate law.

any obligation under the old CBA on the asset purchaser. In addition, the scarce case law suggests that the shift of work cases, Boxes 5 and 6, largely follow Boxes 3 and 4. The preceding reconstruction and comparison of corporate and labor law successorship doctrine sets up a puzzle. The doctrines provide strikingly similar treatments of those with contractual claims on the firm. But differences exist as well. Some of these are relatively small differences, such as the nature of the presumptions. Others are more substantial, such as the duty to bargain imposed on the new firm in Boxes 4 and 6.

What we find most intriguing is that the differences, large and small, revolve in different ways around the same core concept: substantial continuity. Moreover, as noticed above, substantial continuity bears a significant relationship to what economists term the "internal labor market."¹¹⁵ As we hope to show, this clue provides the key to understanding labor law successorship doctrine and its relationship to corporate law successorship doctrine.

III. AN OVERVIEW OF THE ECONOMICS OF INTERNAL LABOR MARKETS

In the preceding reconstruction of the labor law successorship doctrines, we showed that a formal structure based on the corporate law characteristics of the transactions at issue largely describes the courts' and Board's opinions. We believe this analysis is significant because the traditional labor law analyses, by ignoring the formal corporate law characteristics of transactions and focusing instead on the duty at issue,¹¹⁶ have failed to provide a workable taxonomy that describes and predicts cases. The core of our theory of successorship is that the substantial continuity test, which plays such a central role in the labor law successorship doctrines, is largely identical to the labor economists' question whether the internal labor market of the firm has changed.¹¹⁷ In this Part, we outline the relevant economics literature on internal labor markets.¹¹⁸

115. See *infra* text accompanying note 130.

116. That is, the duty to arbitrate, the duty to adhere to the terms of the contract, the duty to bargain, and the duty to redress unfair labor practices.

117. The scope of an asset sale can be either broader or narrower than the predecessor's internal labor market (ILM). When the successor's new ILM is either much broader or narrower than the predecessor's, a threshold question may be whether the new unit is an appropriate bargaining unit. In our discussion of successorship, we assume initially an affirmative answer to this threshold question — that is, that there exists a union of the predecessor's workers that is an appropriate bargaining unit.

118. For a review and integration of the economic analyses of internal labor markets, see Wachter & Wright, *supra* note 54, at 86-108 (citing sources and reviews).

A. *The Internal Labor Market and the Protection of Match-Specific Investments*

Labor economists distinguish between two fundamentally different labor markets. The external labor market (ELM) is the market in which firms seek to fill vacancies and workers search for new jobs. The textbook ELM is segmented by the general skills of the workers, covers broad geographical regions, and contains large numbers of firms and workers. Hence, both the supply and demand sides of the market have numerous parties. There is also a considerable amount of information available to the parties concerning prevailing wages and unemployment rates. Because firms and workers have no investments that are specific to the relationship, it can be terminated at low cost to both parties. As a result, ELMs are typically competitive markets, with little potential for super-competitive returns to one party coupled with below-competitive returns to the other. In other words, there is little potential for successful rent seeking.¹¹⁹

But, as long recognized, the textbook ELM fails to describe the employment relationship observed within firms.¹²⁰ This *internal* labor market (ILM) is very different. In the observed ILM, firms and workers both make investments in their match, which are lost if the relationship is terminated. These investments encompass *both* investments in identifying and training employees *and* joint investments in the organization of work in a firm. Once tied together in the ILM, relevant information is asymmetrically distributed. Firms have private information about product markets and conditions and available technologies while workers have information advantages concerning their own work effort and opportunity wages if a new job were sought. As a result, the ILM, unlike the ELM, is not a competitive market but, rather, is better modeled as a bilateral monopoly with considerable potential for rent seeking.

Why might firms and workers voluntarily eschew the competitive ELM, with its protections, for the bilateral monopoly of the ILM? The ILM literature addresses this puzzle from two directions. First, ILMs generate surpluses over the returns available in the ELM, surpluses sufficiently large that they leave both parties better off even after the costs imposed by rent-seeking behavior. Second, the structures

119. We define *rent seeking* as the expenditure of resources or efforts by one party in order to transfer resources from the other party to itself. This investment by the rent seekers is economically wasteful relative to the joint profits of the parties, because it creates no new wealth. Moreover, rent seeking by one party typically causes the prospective rent payer to expend resources in order to protect its share of the joint investment. Because ELMs involve no joint investments, they provide no opportunity for rent seeking.

120. See Wachter & Wright, *supra* note 54, at 241 & nn.2-3.

adopted in internal labor markets constrain such rent-seeking behavior.

ILM theorists have identified four central economic factors that affect an ongoing employment relationship and that are necessary to explain the observed patterns within ILMs: (1) firm- or match-specific training; (2) risk aversion; (3) asymmetric information; and (4) transaction costs.¹²¹ Relying on a combination of these factors, ILM theorists have been able to analyze otherwise puzzling but widespread features of the employment relationship as incentive-compatible contracts designed to solve the twin problems endemic to ILMs: namely, to encourage the optimal match-specific investments while deterring the parties from using their asymmetric information in a rent-seeking manner.¹²²

From this perspective, for example, one can understand why both the firm and the worker typically invest in the match: it encourages the maintenance of the relationship. If only one party made such a commitment, the noninvesting party could "hold up" the other party, threatening to terminate the relationship unless a higher return were paid. Such a threat would be credible because the investing party, but not the threatening party, would lose the return on its match-specific investment. By contrast, joint investments deter such behavior: because the threatening party would absorb a loss in carrying out its threat to terminate the relationship, the opportunity to use such a threat in a rent-seeking manner is reduced.¹²³

The ILM contract is ongoing and forward-looking. Investment is continuous, and the parties will continue to deal with each other as long as match-specific returns continue to be available and as long as continuing match-specific investments receive adequate protection. The governance structure for those ongoing relationships may be relatively explicit, as in the union sector, or implicit, as in the nonunion sector. In either case, unless rules can be devised to deal with new contingencies, the parties will lose the joint surpluses created by efficient ILMs.

121. See *id.* at 90-99.

122. Incentive-compatible contract terms are terms that make it in the interest of both parties to maximize the joint surplus available to them.

123. Other examples of incentive-compatible terms are seniority clauses, wage profiles that increase with experience, reductions in employment rather than wages during declines in economic activity, and unilateral implementation by firms of decisions affecting levels of output and product prices. For a discussion of these features, see Wachter & Wright, *supra* note 54, at 94-99.

B. *The ILM Analysis of Temporary Layoffs, Discharge for Cause, and Permanent Reductions in Force*

The economic issues raised by successorship are similar to the issues raised by other management actions that have a substantial impact on the employment relationship. In this section we take the first steps toward evaluating whether the successorship rules of labor law are incentive-compatible by considering the ILM theorists' analysis of the termination of the employment relationship in other situations: discharge for cause, temporary layoffs, and permanent reductions in force. In each of these cases, the observed practices appear to prefer permanent reductions in employment over less severe adjustments. While this may initially seem to conflict with the presumed interest of the parties in maintaining the employment relationship, the threat of employment reduction is indeed incentive-compatible for joint-profit maximization, while less severe adjustments would not be.

For example, firms rarely make minor reductions in wages to discipline workers who shirk. Instead, they typically discharge the workers, thereby terminating the relationship. The explanation for this behavior rests on the fact that workers know their work effort, but firms do not. Firms can learn by monitoring, but constant monitoring is very costly. To save on costs, firms monitor workers infrequently. The low detection rate drives the harsh penalty for shirking. If most shirking goes undetected because of the high monitoring costs, firms must penalize workers an amount greater than the expected loss of any specific incident. The penalty must be set so that the expected cost to the workers of shirking equals the loss to the firm. When detection rates are low, the penalty is very high to raise the expected value to required levels. Conversely, to encourage workers to consummate work effort, the firm must offer rewards when it learns of superior effort.¹²⁴

But the penalty for shirking cannot be a wage reduction. If the firm could simply declare that a group of workers were underperforming and cut their wages, firms would have an incentive to overstate the degree of shirking, thereby reducing costs and increasing profits. Forcing firms to discharge workers eliminates the firm's incentive to overstate the degree of shirking because it forces firms to lose valued workers in the process.¹²⁵

A parallel analysis explains the observed behavior of firms in re-

124. See *id.* at 248-49.

125. See Michael H. Riordan & Michael L. Wachter, *What Do Implicit Contracts Do?*, 1982 PROC. INDUS. REL. RES. ASSN. 291, 295 (Barbara D. Dennis ed.).

sponse to cyclical changes in output: firms typically reduce employment rather than wage rates. Firms, but not workers, possess direct information about product market conditions. The firm informs its workforce about product market conditions indirectly through changes in output. If a firm could lower wages in response to a decline in its product market, it would have an incentive to misstate the condition of its product market in order to lower wage rates. The incentive-compatible rule is for the firm to lay off workers. Because the result of the layoffs is a reduction in output, and hence a reduction in the firm's revenues and profits, such a rule eliminates the firm's incentive to misstate information.¹²⁶

The rules concerning firms that exit an industry parallel those governing temporary layoffs. A firm retains the right to decide unilaterally to go out of business, just as the worker enjoys the unilateral right to quit the firm.¹²⁷ The process of going out of business, however, is frequently a prolonged one. Stylized rules have evolved to govern the "effects" on workers of the decision to close: firms typically lay off workers over time using a seniority schedule; workers typically receive some severance pay and always receive their pension rights; if firms discharge older workers before younger ones, they do so through voluntary retirement mechanisms in which the "contract" of the older workers is bought out. These process rules are almost always part of union contracts.¹²⁸

The rule that firms can unilaterally implement a decision to go out of business has strong incentive-compatible properties. Once out of business, the firm has lost whatever value is in the ILM. Hence, the firm will only close when the ILM is indeed unprofitable. The rules governing the process control the firm's incentives to profit from the process, or to pretend to be going out of business, by imposing direct costs (severance pay or voluntary retirement programs) and indirect costs (laying off less expensive junior workers before more expensive senior workers) on such a firm.

The above analysis extends to successorship. The key factor driving the incentive-compatible rules in this area is that the firm and the match-specific workers have an ongoing interest in preserving an ILM when it generates a surplus over the ELM. When the ILM generates

126. For a general discussion of contracts that control firm strategic behavior with respect to product market conditions, see *id.* at 250.

127. *Textile Workers Union v. Darlington*, 380 U.S. 263, 268, 271 (1965); see also *First Natl. Maintenance Corp. v. NLRB*, 452 U.S. 668, 677 (1981).

128. LLOYD G. REYNOLDS, STANLEY H. MASTERS, & COLLETTA H. MOSER, *LABOR ECONOMICS & LABOR RELATIONS* 471-76 (10th ed. 1991). For a general discussion of how parties use stylized rules to adapt to changes in circumstances, see Riordan & Wachter, *supra* note 125.

economic losses, the long-run joint profits of the firm and the workers would be improved by establishing a new ILM. The obligations of the surviving firm turn on whether or not the firm reestablishes or retains the ILM of the old firm.

C. The Problem Faced by Labor Law Successorship Doctrine

From an ILM perspective, three situations are of interest in determining whether successorship doctrine deters rent seeking.

Case A: The ILM of the old firm creates a surplus; the new firm recognizes that the ILM creates a surplus; and the new firm, in order to preserve the efficient ILM, willingly retains the old firm's employees and assumes the CBA and the duty to bargain. *Case A* apparently characterizes most changes of control and rarely leads to litigation.¹²⁹ When the new firm wishes to acquire the old firm as a going business, and to continue it as such, the new firm has no reason to disrupt established and efficient labor relations. Consolidations are difficult enough without making them more so by sowing discord. The easiest way to accomplish *Case A* transitions is by a merger or stock sale.

Case B: The ILM of the old firm is defective, either creating no surplus or incurring losses; the new firm recognizes that the old ILM is defective; the new firm reconfigures the operations, including personnel practices and structures, and hires few if any of the old firm's workers. *Case B* transitions are typically asset sales. *Case B* cases are largely self-enforcing: the firm makes credible its assertion that the ILM generates no surplus by jettisoning it. By dissolving the old ILM, the firm precludes itself from capturing joint surplus generated by that ILM.

Case C: The ILM of the old firm is efficient, but the new firm denies that any surplus exists; at the same time, the new firm attempts to capture the joint surplus by hiring most of the old firm's employees at a wage closer to the employees' opportunity wage and by refusing to bargain collectively. In *Case C*, the new firm tries to have it both ways. It tries to maintain an efficient ILM while reducing the share of the joint surplus paid to the workers. Unlike *Case B* situations, the new firm's representation is not self-enforcing. By (mis)representing that no joint surplus exists, perhaps by threatening not to hire the old workers except at lower wages, the firm creates a basis for reducing workers' wages — and thus their share of the surplus — while at the same time maintaining and benefiting from the efficient ILM.

The task of labor law successorship doctrine, then, is best understood as facilitating *Case A* and *Case B* transitions, while preventing *Case C* transitions. A failure to control the opportunistic behavior of *Case C* will undermine the creation and maintenance of productive ILMs.

129. This is an anecdotal impression. We do not know of any evidence on the relative frequency of *Cases A*, *B*, and *C*.

IV. USING ILM THEORY TO UNDERSTAND THE LABOR LAW SUCCESSORSHIP DOCTRINES

As we have seen above, substantial continuity in operations and workforce plays an important but different role in each box of the taxonomy. Strikingly, the substantial continuity test that forms the core of the labor law successorship doctrine roughly tracks the continuity of the ILM. In determining whether substantial continuity in operations and workforce exists, the courts and the Board examine a number of factors:

whether the business of both employers is essentially the same; whether the employees of the new company are doing the same jobs in the same working conditions under the same supervisors; and whether the new entity has the same production process, produces the same products, and basically has the same body of customers.¹³⁰

Finally, the courts and the Board examine whether there is substantial overlap in the identity of the employees. These factors rather precisely describe the situations in which the new firm retains the old firm's ILM. Thus, the substantial continuity test identifies those cases in which the new firm is in a position to act opportunistically. In this Part, we describe how labor law successorship doctrine can be understood as an attempt to control opportunistic behavior by firms — and, to a lesser extent, by employees — that can threaten productive ILMs.

A. *Column 1: Merger and Stock Sales*

1. *Box 1: Obligations Under the CBA After a Merger or Stock Sale*

As previously discussed, a merger or stock sale does not affect rights and obligations under the CBA.¹³¹ In the normal case, Case A, the new owners desire to acquire the old firm as a going concern, including its ILM either by means of a stock sale or a merger. The rule of Box 1 facilitates such transitions and protects third parties by leaving intact rights and liabilities of the old firm. The rule limits the opportunities for the contracting parties — both the employer and the union — to demand renegotiation of contracts at the delicate and vulnerable period during which control is transferred.¹³² The typical fact

130. *Fall River Dyeing & Finishing Corp. v. NLRB*, 482 U.S. 27, 43 (1987).

131. See *supra* notes 55-63 and accompanying text.

132. The battle for control of United Airlines provides a good example of the strategic use of renegotiation at the point that control is transferred. During the pilot union's attempt to gain control of United, the machinists formed a coalition with the management and inserted a provision in the collective bargaining agreement which terminated the machinists' collective bargaining agreement upon change of control. This action posed a substantial barrier to the pilots' attempt to gain control because it gave the machinists the option to strike upon a change of control and would therefore discourage lenders who preferred not to "lend into a strike." The managers benefited from this provision insofar as it discouraged bids, while the machinists bene-

pattern for a Box 1 case is a stock sale after which the new owners repudiate the old CBA while accepting the benefits of corporate continuity, including tax benefits and the continuation of advantageous contracts, leases, or licenses.¹³³

Note how the essentially categorical rule of Box 1 prevents the opportunistic behavior of Case C. *Esmark, Inc. v. NLRB*¹³⁴ provides a wonderful example. Esmark, a conglomerate, owned the leading meat packer, Swift & Co. Swift's fresh meat operations had been losing money. Esmark claimed that, although Swift's plants were efficient in that the workers were productive and the output was of high quality, the wage rates at two (Moultrie and Guymon) rendered them uncompetitive in comparison to other plants in the industry. Esmark thus attempted to retain their ILMs but to lower wage rates by reorganizing operations in such a way as to put the two plants outside the master CBA. In addition, Esmark wanted to sell sixty-five percent of the fresh meat operations to the public, retaining a thirty-five percent interest. Five days before the public offering, Esmark closed the Moultrie and Guymon plants and laid off the workers. Eight days after the public offering, an official of New Sipco, the subsidiary that now held the two plants, informed the union that it would reopen them and that, as a "successor employer," it would unilaterally set (lower) wage rates.

Esmark's public sale of sixty-five percent of the stock in the subsidiary holding the fresh meat operations presented a classic Box 1 situation: Does the corporation remain bound by its obligations under the CBA after the sale of a majority of its stock to new owners? Following *Wiley*, the court affirmed the Board's holding that the obligations survived the stock sale.¹³⁵

The corporate law considerations discussed earlier show why this result makes sense. In this case, one purpose of using a stock sale rather than an asset sale was to maintain and transfer the enterprise intact, including its ILM.¹³⁶ In such circumstances, to treat the firm's

fired to the extent that it allowed them to claim a share of any merger gains. See John C. Coffee, Jr., *Unstable Coalitions: Corporate Governance as a Multi-Player Game*, 78 GEO. L.J. 1495 (1990).

133. See, e.g., *Esmark, Inc. v. NLRB*, 887 F.2d 739, 744-45 (7th Cir. 1989); *EPE, Inc. v. NLRB*, 845 F.2d 483, 486 (4th Cir. 1988); *General Teamsters Local Union No. 249 v. Bill's Trucking, Inc.*, 493 F.2d 956, 958 (3d Cir. 1974); *Phillip Wall & Sons, Inc.*, 287 N.L.R.B. 1161, 1163-64 (1988); *Topinka's Country House, Inc.*, 235 N.L.R.B. 72, 73 (1978).

134. 887 F.2d 739 (7th Cir. 1989).

135. 887 F.2d at 752.

136. As the court noted:

Esmark deliberately chose to dispose of Swift's fresh meats division as an ongoing, self-sufficient enterprise, rather than to sell its physical assets piecemeal. Esmark undoubtedly

obligations to its employees *less* favorably than its contracts with others, allowing the firm to pick and choose which of its obligations to its employees to adopt, would undermine a transactional form whose value lies largely in the way it predictably and maximally maintains continuity.¹³⁷ Undermining the categorical quality of the merger-stock sale rule, in turn, would invite opportunistic behavior by the employer and the union in the Case *A* situations that, under current doctrine, pass largely unlitigated.

In contrast to these typical Box 1 cases, sometimes a merger results in the old firm's absorption into the surviving firm, with the work and workers dispersed and integrated or dismissed.¹³⁸ This represents a Case *B* type situation: by integrating the old ILM into its existing ILM, the firm indicates that it does not believe the old ILM is generating a surplus.¹³⁹ In the *Wiley* case, for example, the Interscience workers were integrated into the larger Wiley workforce.

Under the rule of Box 1, these employees receive the same protection as other creditors of the firm. The surviving firm is liable for any obligations under the old CBA. At the same time, the surviving firm has no greater obligations than the old firm. Just as the old firm typically could dissolve the ILM by changing the nature of its operations so significantly as to render the old CBA inapplicable, so too can the new firm.¹⁴⁰ When, as in the *Wiley* case, the new firm credibly asserts that it does not value the old ILM — either by integrating the workers into its larger operations or by not retaining the old workers — it may

believed that the form of the transaction would be advantageous, due to the tax consequences and because Sipeo's contracts (including favorable loan agreements, leases and contracts with suppliers and customers) would continue in force.

887 F.2d at 751.

137. The court seemed to be searching for this view in *Esmark* without ever quite articulating it. In rejecting *Esmark*'s argument, the court stated that adoption "would undermine the fundamental goal of the federal labor laws, which is to ensure industrial peace and *stability*. An employee should not have to wonder whether his employer will continue to adhere to his contractual obligations every time the employer's stock is traded on a stock exchange." 887 F.2d at 752. But *why* should the employee have that reassurance? One answer is that such reassurance is just and promotes industrial peace. As a legal theory, however, that answer does not explain the cases: if reassurance promotes justice and industrial peace here, why not also guarantee it in cases involving a sale of assets (Box 3) or a shift of work (Box 5)? The background corporate law theory offers an alternative explanation for why the reassurance is critical, an explanation that can distinguish between Box 1 cases like *Esmark* and Box 3 and Box 5 cases like *Howard Johnson* and *Burns*. See also cases cited *supra* note 133, in which the stock purchaser tried to avoid the obligations under the CBA, while enjoying benefits of other continuing contracts, licenses, or leases.

138. See, e.g., *John Wiley & Sons, Inc. v. Livingston*, 376 U.S. 543 (1964) (dispersed and integrated); *Lauer's Furniture Stores, Inc.* 246 N.L.R.B. 360 (1979) (dismissed).

139. Or, at least, that the surplus is less than that generated by its own ILM.

140. This, of course, assumes that the CBA does not have a clause restricting the changes under consideration. Like others linked to the firm by contract, the bargained-for rights of either the firm or the union will be protected.

do so. Such an assertion is credible because, by dissolving the old ILM, the firm precludes itself from capturing any surplus generated by the old ILM.

Here, then, is an important contrast between *Esmark* and *Wiley*. In *Esmark*, the surviving firm could not claim that the CBA became inapplicable because of permitted changes in the organization of the work and workers: the operations at the two plants continued entirely unchanged. By contrast, in *Wiley*, the Interscience workforce was completely absorbed into the larger Wiley operation, a reorganization permitted under the CBA. The rule of Box 1 thus provides the necessary flexibility to reorganize or dissolve an ILM when it fails to generate a surplus, without interfering with the efficient — and largely uncontested — transfer of going concerns. Placing the burden on the employer to establish lack of continuity is consistent with our casual observation that, in the normal Box 1 case, the surviving firm or stock purchaser will keep the old ILM intact.

2. *Box 2: Obligations Under the NLRA After a Merger or Stock Sale*

The rule of Box 2 follows that of Box 1: after a merger or stock sale, the surviving firm has the same duty to bargain as the old firm. The corporate and ILM perspectives largely account for this result. In Case *A* situations, the most common type, this rule maximally preserves continuity. At the same time, in Case *B* situations, when the new firm believes that the old ILM is unproductive, the rule provides the same way out as was available to the old firm. If the new firm can meet the burden of establishing that the union does not have continued majority support, then it need not bargain. As previously discussed, to establish this the new firm, like the old firm, must establish lack of continuity in operations and workforce.¹⁴¹

While permitting a way out of the duty to bargain for firms that in fact do not desire to continue the old ILM, however, this rule largely blocks the Case *C* attempt to have the best of both worlds, that is, the attempt to benefit from the old ILM while repudiating the duty to bargain. In the classic Case *C* situation, the new owners retain the old ILM but attempt to secure a greater share of the joint surplus. The new owners, for example, may misinterpret the condition of the product markets. "Sales are bad," the new owner might say, "we just can't afford to maintain the old wage rates." Alternatively, the new owner may attempt to maintain the old ILM organization but eliminate the

141. See *supra* notes 65-68 and accompanying text.

old workers. Box 2 blocks both strategies. Thus, in *Esmark*, in which the old firm was preserved entirely intact with the same workers and the same operations, the court correctly held that the duty to bargain continued unchanged through the sale of stock. Because the ILM continued, the new owner could not rebut the presumption of continued majority support.

But now contrast *Esmark* with *Spencer Foods*¹⁴² and *Rockwood Energy*.¹⁴³ *Spencer Foods* presents the trickier case. The original owners closed the plant and laid off the workers. After an eighteen-month hiatus, following a stock sale, the new owners reorganized operations slightly and reopened the plant. The new Spencer Foods refused to bargain with the old union, accepted applications from all interested persons — including former employees — but hired only a very small proportion of former Spencer employees. The union charged — and the administrative law judge, the Board, and the court all agreed — that Spencer Foods relied on hiring criteria designed to keep the former unionized Spencer employees to a minimum and thus keep the union out of the plant.¹⁴⁴

The court held that, because the layoffs were not intended to be permanent, but only part of the “sale of an ongoing business enterprise to [Land O’Lakes], i.e., a business which encompassed the resumed operations of the Spencer plant by [Spencer Foods] albeit under new management,”¹⁴⁵ and because there was an expectation that the plant would be reopened, the duty to bargain carried forward beyond the expiration of the CBA and through the hiatus. Moreover, the court held that applying discriminatory criteria to avoid rehiring old workers was itself an unfair labor practice.

From the ILM perspective, *Spencer Foods* is more problematic than *Esmark*. At first blush, it seems to involve a classic Case B situation: the new Spencer Foods, by not rehiring the old employees, made clear that it did not value the old ILM. The old Spencer Food’s history of poor labor relations is consistent with this hypothesis. While in *Esmark* the firm attempted to have it both ways — to retain the ILM but avoid bargaining with the union — the new Spencer Foods put its money on the line. How, then, could Spencer Foods have been behaving opportunistically?

Doctrinally, the answer is straightforward: antiunion animus is al-

142. *United Food & Commercial Workers Intl. Union v. NLRB*, 768 F.2d 1463 (D.C. Cir. 1985).

143. *NLRB v. Rockwood Energy & Mineral Corp.*, 942 F.2d 169 (3d Cir. 1991).

144. 768 F.2d at 1475.

145. 768 F.2d at 1472.

ways an unfair labor practice.¹⁴⁶ Moreover, the economic rationale for this general rule is similarly straightforward. Without such a bar, workers would be unable to escape from their free-rider problems and bargain collectively. Hence, if unions can facilitate efficient contracting in ILMs, a rule prohibiting antiunion animus is necessary.

But the successorship context itself also provides an answer. Consider a broader time frame. Suppose that in the first period the firm refuses to rehire former employees in order to keep out the union, but during the second period it rehires the skilled former employees as it terminates the unskilled and inexperienced new hires.¹⁴⁷ Under such circumstances, in the second period the workers would have to bear the cost and delay of reorganizing and renegotiating, having just suffered an extended layoff due to their union membership. By delaying the reestablishment of the efficient ILM in order to eliminate the union, the firm might secure a greater share of the joint surplus. Indeed, more generally, given that the division of the joint surplus — like other bilateral monopolies — depends on the bargaining abilities of the participants, investing in a reputation for toughness may be worthwhile.¹⁴⁸

Note the limitations of this explanation. In this two-period strategy, the firm incurs a cost during the first period: it forgoes its share of the joint surplus of the efficient ILM and risks losing employees in whom it has made a match-specific investment. The strategy makes sense only if the employer can recoup this investment, with interest, in the second period — either after it reestablishes the old ILM, or from an increased share of the joint surplus from other ILMs within the firm, that is, from other divisions.¹⁴⁹ In *Spencer Foods*, this is a plausible scenario in that Land O'Lakes had numerous other divisions. Moreover, had there been no litigation, Spencer Foods could have

146. Labor Management Relations (Taft-Hartley) Act, Pub. L. No. 80-101, § 8(a)(3), 61 Stat. 136, 140 (codified as amended at 29 U.S.C. § 158(a)(3) (1988)); *Textile Workers Union v. Darlington Mfg. Co.*, 380 U.S. 263 (1965). See generally 1 THE DEVELOPING LABOR LAW, *supra* note 1, at 185-249, 275-84.

147. *Spencer Foods* provides one possible example. The Board found that, in the first year following the sale of assets, Spencer Foods hired approximately 525 individuals, released 250, and sought to fill 220 projected periods; the Board noted the relative inexperience of many hires. *United Food & Commercial Workers Intl. Union v. NLRB*, 768 F.2d 1463, 1475 (D.C. Cir. 1985).

148. The classic case of antiunion animus, *Darlington*, rested on similar concerns. The Court reasoned that Darlington closed one of its plants to teach workers in its other plants not to unionize. 380 U.S. at 275-76.

149. Predatory pricing in antitrust provides an analogous case. In a predatory pricing strategy, a firm lowers its prices below cost to drive competitors out of the market and, having gained market power, charges an above-competitive price. *Brook Group Ltd. v. Brown & Williamson Tobacco Corp.*, 113 S. Ct. 2578 (1993); see also Phillip Areeda & Donald F. Turner, *Predatory Pricing and Related Priorities Under Section 2 of the Sherman Act*, 88 HARV. L. REV. 697 (1975).

been expected to rehire the experienced workers as it fired the inexperienced workers. But, if recoupment is impossible, it is unlikely that the initial decision was opportunistic.¹⁵⁰

In contrast to the court's analysis in *Spencer Foods, Rockwood Energy*¹⁵¹ seems inconsistent with the goal of preventing opportunistic behavior. In 1981, Harmony Mining Co. entered into a collective bargaining agreement effective through September 1984. The CBA provided that "[e]mployees who are idle because of a reduction in the working force shall be placed on a panel from which they shall be returned to employment on the basis of seniority."¹⁵² In May, 1982, Harmony suspended production and laid off forty unit employees. In 1983, Rockwood Energy and Mineral Corp., Harmony's major creditor, acquired all of Rockwood's stock. In 1985, after the termination of the CBA, Harmony unilaterally began to change the terms for the sole remaining unit employee. In 1986, Harmony hired one additional nonunion employee to do work that union members had previously performed. In 1987, Harmony resumed production, hiring two additional employees without regard to the panel, of whom only one was a former union member. Four laid-off union members inquired about jobs but were told that the company was not accepting applications.¹⁵³

The union requested bargaining and, when Harmony refused, filed an unfair labor practice complaint. The Board ordered that Harmony recognize and bargain with the union, that Harmony not unilaterally change the terms and conditions of employment established by the now expired CBA, and that Harmony recall laid-off employees in accordance with the seniority provisions of the CBA.¹⁵⁴ The Third Circuit enforced the order, finding that the Board had reasonably held that the new employer was a "continuation" of the old notwithstanding the long hiatus in production and lack of substantial work force continuity.¹⁵⁵ The obligations under the prior CBA and the duty to bargain both carried over.

150. As in the analogous case of predatory pricing. See, e.g., *Brook Group*, 113 S. Ct. at 2588-89 (holding that a plaintiff must show that its competitor had a reasonable prospect of recouping its investment in below-cost prices to recover damages in an action for predatory pricing).

This explanation has an important problem. If employees know of a firm's reputation as antiunion *before* they invest in the match, then workers in the competitive external labor market should demand a premium for joining this particular firm. In such cases, the firm would likely bear the cost of its reputation.

151. *NLRB v. Rockwood Energy & Mineral Corp.*, 942 F.2d 169 (3d Cir. 1991).

152. 942 F.2d at 172.

153. 942 F.2d at 172.

154. 942 F.2d at 172-73.

155. 942 F.2d at 174-75.

In contrast to *Esmark* and *Spencer Foods*, the facts here, though not entirely clear, suggest that *Rockwood Energy* presents a Case B situation. The fundamental change in operations associated with reducing from forty workers to four, combined with the company's decision not to rehire the old employees, suggests that *Rockwood Energy* involves a self-enforcing statement that the old ILM generated no surplus. By terminating the old ILM, the company precluded itself from acting opportunistically. But we have too few facts to understand *Rockwood Energy* fully. If, for example, the company were to expand its operations back to its former level, with forty employees, then the case would resemble *Spencer Foods*.

Under this analysis, the opportunistic behavior present in *Esmark* makes clear that the sale of stock does not and should not affect the duty to bargain. Rather, the ILM perspective suggests that the substantial continuity determination — that is, the question whether the ILM is carried forward — should be critical to deciding whether the duty to bargain continues. When, as apparently occurred in *Rockwood Energy*, the firm constrains itself from behaving opportunistically by disbanding the old ILM, imposing a duty to bargain is likely to reduce joint profits. Moreover, because the purpose of imposing such a duty is to preclude opportunistic or wasteful strategic behavior, its imposition serves no purpose in such a context. Focusing directly on substantial continuity, moreover, promotes these purposes more effectively than focusing on the existence of continued majority union support in the workforce — the traditional, and doctrinal, test.¹⁵⁶ *Rockwood Energy*, for instance, may have been able to rebut a presumption of majority status. Doing so, however, would have been quite costly, dissipating the efficiency gains from its reorganization of the company.

B. Column 2: Sale of Assets

In the paradigmatic sale of assets, the asset purchaser wishes only to acquire pieces of the asset seller, not to acquire the asset seller as a going concern. The normal Column 2 case is thus a Case B situation: the asset purchaser does not value the old ILM and, by jettisoning it, precludes itself from capturing any of the old ILM's joint surplus.

Importantly, Case B situations are largely self-enforcing. In these cases, the firm's representation that the old ILM is inefficient, combined with the firm's actions in reconfiguring the assets and not hiring

156. For a discussion of the traditional majority support test, see *supra* notes 65-68 and accompanying text.

the old workers, makes the assertion inherently credible. By dissolving the old ILM, the firm puts its money where its mouth is. While the firm may be wrong — it may be that, contrary to the firm's assertion, the old ILM creates joint surplus — it cannot be acting opportunistically.

Thus, in the Case *B* situation, in which the asset purchaser does not continue the old operation or hire the old workers, there is no continuing ILM that requires protection; hence the law treats the former workers exactly the same as any other creditor of the firm. When the ILM is discontinued, the backward-looking corporate law protection of creditors of the asset seller protects former employees' contractual claims. Workers may collect from the asset seller anything to which they are contractually entitled under the CBA — for example, unpaid wages, accrued vacation pay, accrued pension contributions, and so forth — but that is all. The asset purchaser has no special obligations to the seller's employees.

Moreover, such a rule helps to discourage both the destruction of productive ILMs and the preservation of unproductive ILMs. An ILM may be inefficient because the workers have used their right to strike to extract a contract that transfers the firm's share of the surplus to the workers.¹⁵⁷ Similarly, workers may want to retain an ILM which is inefficient for other reasons in order to maintain contract provisions that return a surplus to them, even when the firm is generating losses. In both cases, a predecessor firm stuck with such an inefficient ILM can jettison it through an asset sale. Faced with the potential exit of the firm through an asset sale, workers will be less likely to use their bargaining power to extract a surplus that leaves the firm with losses.

That the prototypical Column 2 case involves an inefficient ILM also explains why Column 2 has different rules than Column 1. The corporate law goal of encouraging efficient restructuring of those assets that do not generate a surplus, while retaining those that do, requires standard form mechanisms that can be applied to the two situations at low cost. This explains why *Wiley*, contrary to the expectations of traditional labor law scholars, did not apply to Column 2.¹⁵⁸

Of course, as in the corporate context, a background rule that asset purchasers do not take on the seller's obligations creates the potential for Case *C* strategic manipulation. This rule offers asset purchasers an opportunity to retain the productive old ILM, but secure a larger

157. See *infra* the discussion of "potentially efficient" ILMs in note 172 and accompanying text.

158. See *supra* section II.C.

share of the joint surplus, by using an asset sale rather than a merger in order to escape from the old CBA and the duty to bargain. Consequently, asset buyers and sellers will have an incentive to share in the additional portion of the joint surplus that the sale captures from the employees.

The challenge for the legal rule is to preserve the necessary option of dissolving an inefficient ILM and disposing of assets while blocking the opportunistic use of that transactional form. The rules of Boxes 3 and 4 represent an attempt to do this. Because Box 3 poses the most difficult questions, we will first examine the rule of Box 4.

1. *Box 4: Obligations Under the NLRA After an Asset Sale*

Recall the rule of Box 4: when there is no substantial continuity, there is no duty to bargain collectively until the union establishes majority support; when there is substantial continuity, majority support is presumed, and the firm must bargain collectively until it establishes lack of majority support.¹⁵⁹ As discussed above, when the asset purchaser jettisons the old ILM, as demonstrated by lack of substantial continuity, no danger exists of opportunistic behavior on the part of the firm. But when the asset purchaser retains the old ILM, a potential for opportunistic behavior arises that courts must constrain in order to facilitate optimal investments in ILMs.

The necessity of controlling this sort of opportunistic behavior provides an explanation for why labor law successorship doctrine grants greater protection to employees than corporate law successorship doctrine grants to creditors generally. In the general corporate case, courts protect creditors either by requiring that the asset seller make provision for long-tail claimants before dissolution or by using asset purchasers as a conduit to impose the costs on asset sellers. But the ILM differs significantly: labor law successorship doctrine must protect the forward-looking, match-specific investments in the continuing ILM.

The duty to bargain is critical to labor law's attempt to constrain opportunistic behavior while facilitating nonopportunistic reconfigurations of assets. Here we must clarify the content of the duty to bargain and the extent to which it can protect employees. In referring to a "duty to bargain," we are referring to the weak, procedural version of the duty: an obligation to meet and confer "in good faith" over mandatory topics, without any obligation to reach an agreement.¹⁶⁰

159. See *supra* notes 87-88 and accompanying text.

160. See generally 1 THE DEVELOPING LABOR LAW, *supra* note 1, ch. 13.

Such a duty to bargain will facilitate the renegotiation of terms and conditions equivalent to those in the prior ILM. But this duty only protects workers in whom the firm has made productive investments. It does nothing to protect employees who are easily replaced. In particular, the duty to bargain will not allow such employees to protect any union wage premiums that they previously secured in the old CBA.¹⁶¹

The duty to bargain constrains opportunistic behavior in this context in two ways. First, by relieving the union from the burden of showing majority support — with the attendant costs of organizing and costs of delay — imposing a duty to bargain lowers the employees' costs of protecting or reestablishing the bargain over the division of the joint surplus that they had previously struck with the asset seller. Second, by forcing the asset buyer to corroborate claims regarding the condition of the product markets, this duty makes it more difficult for the new employer to secure a greater share of the joint surplus by misrepresentation.

Consider, for example, *Fall River*,¹⁶² in which a majority of the asset purchaser's workforce had worked for the asset seller, doing essentially the same work. In such circumstances, employees face a continuing danger that the purchaser will act opportunistically, claiming that the ILM is inefficient in order to appropriate a portion of the joint surplus while at the same time taking full benefit of its value. Imposing a duty to bargain helps to maintain the presumptively efficient ILM while preventing the asset purchaser from using the uncertainty of the changeover to secure a greater share of the joint surplus.

Moreover, such a rule imposes a minimal burden on the asset purchaser. If the purchaser values the ILM, as demonstrated by its decision to continue operations and to hire the old employees, then it must continue the practice of bargaining collectively. If, on the other hand, the purchaser does not value the ILM, it will not hire the old employees and will have no obligation to bargain collectively. Indeed, in *Fall River* the Supreme Court seemed largely to have made a version of this argument:

Thus, to a substantial extent the applicability of *Burns* rests in the hands

161. The extent to which labor law should or does protect union wage premia for unskilled workers is a controversial topic and well beyond the scope of this article. For one view of this topic, see generally Michael Wachter, *Union Wage Rigidity: The Default Settings of Labor Law*, AM. ECON. REV., May 1986, at 240. However one comes out on the normative issue, most agree that the NLRA as applied provides relatively little protection for workers easily replaced in the ELM. Labor law successorship doctrine, as reconstructed here, is thus no less protective of such workers than other areas of labor law.

162. *Fall River Dyeing & Finishing Corp. v. NLRB*, 482 U.S. 27 (1987).

of the successor. If the new employer makes a conscious decision to maintain generally the same business and to hire a majority of its employees from the predecessor, then the bargaining obligation of § 8(a)(5) is activated. This makes sense when one considers that the employer *intends* to take advantage of the trained work force of its predecessor.¹⁶³

The rule prohibiting discrimination against employees of the asset seller on the basis of their union membership reenters at this point.¹⁶⁴ As with Box 2, if the asset purchaser could maintain operations unchanged but escape from the duty to bargain — by refusing to hire former union members or by refusing to recognize the union — then an opportunity would exist for unproductive strategic behavior.¹⁶⁵

The rule against antiunion animus blocks this prospect. If an asset purchaser leaves operations unchanged but employs practices that effectively exclude former union employees, such action constitutes evidence of antiunion animus. After all, so long as operations are unchanged, one would expect that the old employees in whom the firm has made match-specific investments would be the most attractive candidates. If a firm disproportionately excludes the most attractive applicants, one can infer that it excluded them in order to keep out the union.¹⁶⁶ By contrast, when no substantial continuity in operations exists, no such inference arises. To the extent that the operations are changed, the match-specific investments in and by the old employees have little value — indeed, they may even impose a cost — and criteria of selection that have the effect of hiring new workers do not suggest animus.

But this ILM explanation for the rule of Box 4 presents a puzzle: if the duty to bargain is part of the old ILM and is therefore appropriately imposed on an asset purchaser who retains the old ILM, why not also impose the old CBA, which is its constitutive document? The doctrinal answer has been that the NLRA prevents the imposition of an agreement on a firm. But that justification begs the question: it does not explain why the NLRA *should* distinguish between asset purchasers — who are not necessarily deemed to adopt a CBA even if they hire a majority of the employees — and stock purchasers, who *are* deemed to accept the existing CBA.

163. 482 U.S. at 40-41.

164. See *supra* notes 141-46 and accompanying text.

165. See *supra* text accompanying notes 146-50.

166. See, e.g., *United States Marine Corp. v. NLRB*, 944 F.2d 1305, 1315-17 (D.C. Cir. 1991), *cert. denied*, 112 S. Ct. 1474 (1992); *United Food & Commercial Workers Intl. Union v. NLRB*, 768 F.2d 1463, 1474-76 (D.C. Cir. 1985).

2. *Box 3: Obligations Under the CBA After an Asset Sale*

As discussed earlier, the rule governing Box 3 is complex. In general, when a firm acquires assets, it need not fulfil the obligations of the seller's collective bargaining agreement, unless it agrees to accept those obligations.¹⁶⁷ The Board and the courts have outlined the circumstances in which they will hold that a firm has agreed to take on the seller's CBA in the *Spruce Up* doctrine.¹⁶⁸ Proof of substantial continuity in operations and workforce seems to make it significantly more likely that the Board and courts will find that the CBA has been adopted, evidence which the asset purchaser can rebut with a clear statement at the outset that it does not intend to adhere to the old CBA. The uncertain and fact-specific nature of the legal rule puts pressure on the purchaser to declare its intentions, explicitly rejecting the old CBA at the outset if it does not wish to adhere to it.

This complex rule seems to be a necessarily imperfect solution to a difficult problem. The core of the Box 3 rule comports with ILM considerations. A new owner who wishes to redeploy the assets of the firm might find that goal difficult to accomplish if bound by an existing CBA. Allowing the new owner to reject the CBA thus furthers the corporate law goal of encouraging the mobility of assets to the most profitable use. Moreover, when an asset purchaser acquires assets but redeployes them and hires new employees, we face an obvious Case B situation. By dissolving the old ILM, the asset purchaser precludes itself from acting opportunistically.

*Howard Johnson*¹⁶⁹ presents just such a nonopportunistic Box 3 scenario. Howard Johnson acquired the physical assets from the Grissoms but chose to redeploy them and to hire new employees. By not hiring the old employees, Howard Johnson made it clear that it did not value the old ILM. Moreover, this claim was self-enforcing: by not hiring the old employees, it also gave up the surplus, if any, from the ILM. Instead, Howard Johnson sought to redeploy the assets in what it thought would be a more effective fashion.

While Howard Johnson had no continuing duties to the old employees, it does not follow that the old employees had no protections. To the contrary, they retained all their contractual rights. Indeed, the Grissoms agreed to arbitrate the extent of their liability to the union and their former employees under the CBA. Moreover, as the Court pointed out, because the old employees' CBA contained a successor

167. See *supra* section II.C.1.

168. See *supra* notes 98-101 and accompanying text.

169. *Howard Johnson Co. v. Detroit Local Joint Executive Bd.*, 417 U.S. 249 (1974).

and assigns clause, they could have sought an injunction against the Grissoms to enjoin the sale as a breach of the successorship clause.¹⁷⁰

But a rule that gives the asset purchaser the option to reject the old CBA presents the possibility of a Case C situation. The asset purchaser who can retain the old ILM — as demonstrated by hiring the old employees and retaining the old operations — but who can reject the old CBA and unilaterally set terms and conditions may be able to capture some additional elements of the joint surplus, subject to a continuing duty to bargain.

One mechanism for constraining such opportunistic behavior is a rule that would automatically impose the old CBA on the asset purchaser who retained the old ILM. In such cases, the asset purchaser could not unilaterally set terms; rather, it would have to wait until the CBA expired and then bargain to impasse, or, if the CBA had already expired, bargain to impasse, maintaining the old terms for the year or two it took to do so.¹⁷¹

But such a rule has its costs. In particular, when the ILM generates surpluses over the external labor market but wage premiums exceed the joint surplus, asset purchasers either will not purchase the assets or will not retain the ILM. Such ILMs might be termed “potentially efficient” ILMs, that is, ILMs that would generate a joint surplus at contract terms that fell between the old CBA and a new CBA and that would pass a market test of attracting new workers. In such circumstances, a legal rule that provides a process for the parties to retain such ILMs, but with different CBA terms, will maximize the parties’ joint gains.¹⁷²

The rule of Box 3 seems to be an attempt to accomplish just such a goal. By rebuttably inferring the constructive adoption of the old CBA when substantial continuity exists, the law forces the asset purchaser to reject the old CBA explicitly before it can unilaterally set initial terms. This obligation to reject the old CBA explicitly, combined with an obligation to bargain, provides substantial protection for employees’ match-specific investments. A firm which must repudiate the old CBA explicitly — at the very time it seeks both to hire the old

170. 417 U.S. at 258 n.3.

171. The Fifth Circuit adopted this approach in *United States Gypsum Co. v. United Steelworkers*, 384 F.2d 380 (5th Cir. 1967), *cert. denied*, 389 U.S. 1042 (1968). For a discussion of *Gypsum*, see *supra* note 96. Other courts have charted a middle ground: imposing a duty to bargain about initial terms but not imposing the existing CBA. See, e.g., *Kallmann v. NLRB*, 640 F.2d 1094, 1102-03 (9th Cir. 1981). When a CBA has not expired, this does not affect initial terms but reduces the time until impasse is reached.

172. The process is thus somewhat analogous to a chapter 11 reorganization: the “going concern” value of the ILM is retained while the claims on the cash flow are reduced to a sustainable level.

workers at lower wages and preserve the old ILM intact — must accept the risk of disrupting its jointly profitable relationships with its employees during that difficult transition period. When the ILM is efficient, this sort of behavior is particularly risky because any gain may be temporary at best, given that the firm will still have a duty to bargain. Indeed, gains may be nonexistent because the union may get everything back. As a continuing participant in the ILM, moreover, the firm's strong interest in maintaining its reputation may also constrain opportunistic behavior when either the joint surplus of the present ILM is relatively large, or the prospective gain from opportunistic behavior is relatively small.

*Saks & Co. v. NLRB*¹⁷³ presents an example of a permissible, nonopportunistic scenario. Saks, which formerly shared a building and an alterations department with Gimbels, moved to a separate building. Most of the employees in Saks' new alterations department had worked for Gimbels on Saks alterations. Saks made it clear at the outset that it would not adopt Gimbels' CBA. In such a case, Saks' implicit assertion that the wage rates of the old ILM were uncompetitive is at least partially bonded by the risk it takes of losing experienced workers.

By contrast, *NLRB v. World Evangelism, Inc.*¹⁷⁴ presents an opportunistic scenario, which the rule of Box 3 blocks. World Evangelism (WEI) purchased a hotel-office-convention center complex. Shortly before the takeover, WEI decided to retain the engineers but did not state whether or not it would adopt the CBA. When the engineers heard this, they threatened to resign unless WEI adopted the old CBA. WEI's representative assured the engineers that WEI would adopt the CBA. When the engineers subsequently presented a CBA, WEI refused to sign and, over the succeeding months, paid the engineers below the contractual rate. Subsequently, WEI notified the union that it had not adopted the old CBA. In that case, WEI, having maintained the productive ILM intact during the critical transition period — the period during which the employees' bargaining power was at its zenith — subsequently sought to change the terms unilaterally, capturing a larger share of the joint surplus. The court, applying the *Spruce Up* doctrine, held WEI to the terms of the old CBA.¹⁷⁵

173. 634 F.2d 681 (2d Cir. 1980).

174. 656 F.2d 1349 (9th Cir. 1981).

175. 656 F.2d at 1355-56. *Bellingham Frozen Foods, Inc. v. NLRB*, 626 F.2d 674 (9th Cir. 1980), *cert. denied*, 449 U.S. 1125 (1981), presents a similar but less dramatic scenario. In that case, the asset purchaser (Bellingham) informally asked employees to remain in their current positions without having to reapply. It first indicated that it intended unilaterally to change the terms and conditions of employment a week after the changeover and transfer of operations.

The rule of Box 3, then, allows asset purchasers to avoid the old CBA even when they retain the old workforce if they explicitly reject the CBA in advance. One might object, however, that this rule *invites* opportunistic behavior: firm *X* could sell the assets of its division *Y* to firm *A*, while firm *A* sells the assets of its division *B* to firm *X*. Because each firm could reject the CBA of the newly acquired division, firms would have an incentive to assist one another, reciprocally or serially, in escaping from collective bargaining obligations.

Our answer to this objection lies in considering the *joint* effect of Box 3 and Box 4 rules. Recall that, while a firm that purchases assets may repudiate the CBA, it may still have a statutory duty to bargain. The bargaining obligation survives independently of the CBA and provides extra protections for workers in asset sales.¹⁷⁶ Thus, a new owner who rejects the existing CBA but retains the old workers is likely to find that it has also retained the duty to bargain. In such cases, the duty to bargain provides those workers who have match-specific investments with an opportunity to reinstate the CBA protections they enjoyed with the prior owner. The preceding objection, in this light, demonstrates the power of our analysis. The rule of Box 3 reflects current law: firms legally *could* engage in exactly the sort of opportunistic behavior that the objection suggests. But there is no evidence that they do. The absence of such behavior provides strong evidence of the efficacy of the current legal structure in preventing opportunistic behavior. The duty to bargain, even without an additional duty to abide by the terms of the old CBA, seems to make this tempting strategy unprofitable.¹⁷⁷

C. Column 3: Shift of Work

Labor law, unlike corporate law, presents a third sort of paradigm case: the shift of work case. In these cases, the forward-looking nature of labor law successorship doctrine most clearly comes to the fore. In corporate law, a competitor who takes over an account and, after doing so, contracts with some of the loser's input suppliers owes no obligations to the creditors of the loser. But labor law, with its focus on the potential gains to the new employer of retaining the old ILM, takes a different approach. As discussed above,¹⁷⁸ the *Burns* case holds that, in a shift of work context, the new employer who maintains substantial continuity, principally determined by hiring the

176. See *supra* notes 107-09 and accompanying text.

177. Such evidence is not, however, conclusive: firms might not engage in such behavior for other reasons, such as to avoid unfavorable tax consequences.

178. See *supra* notes 102-09 and accompanying text.

loser's employees, takes on a duty to bargain collectively but not a duty to abide by the old CBA. Again, it is useful to consider the duty to bargain, Box 6, before the obligations under the old CBA, Box 5.

1. *Box 6: The Duty To Bargain After a Shift of Work*

As discussed above, the rule of Box 6 is that, when there is substantial continuity, the new employer has a duty to bargain collectively.¹⁷⁹ The demands of the ILM explain this obligation that departs so strikingly from the parallel corporate law rule. As discussed above, the "substantial continuity" test identifies those situations in which the ILM is preserved.¹⁸⁰ The ILM is, however, both backward and forward looking: both the firm and the employees have sunk and make continuing firm-specific investments, investments that the governance device of the duty to bargain serves to protect. When the new firm continues the old ILM, imposing the duty to bargain protects those ongoing investments and thus promotes an optimal level of investment.

A second theme of the shift of work cases is asymmetry of information and the resulting inequality of bargaining power, a factor that ILM theorists have identified as important in explaining ILMs. The new employer apparently does not act opportunistically, as it had no prior relationship with the employees and has no contractual relationship with the old employer. Nonetheless, the new employer is in a position to misrepresent its intentions strategically in order to retain the efficient ILM while reducing the workers' share of the joint surplus. This theme appears clearly in *Fall River*: "During a transition between employers, a union is in a peculiarly vulnerable position. It has no formal and established bargaining relationship with the new employer, is uncertain about the new employer's plans, and cannot be sure if or when the new employer must bargain with it."¹⁸¹ To explain the imposition of the duty to bargain, an element of opportunism, asymmetric information, or unequal bargaining power is necessary. Otherwise, one would expect that if, indeed, the duty to bargain facilitates optimal investment in the ILM, the new firm would voluntarily bargain collectively.

The *Burns*¹⁸² case illustrates both features of the analysis. In rehiring the Wackenhut guards to perform the same work in the same plant in largely the same way, Burns acknowledged by its actions the

179. See *supra* notes 106-09 and accompanying text.

180. See *supra* note 130 and accompanying text.

181. *Fall River Dyeing & Finishing Corp. v. NLRB*, 482 U.S. 27, 39 (1987).

182. *NLRB v. Burns Intl. Sec. Servs., Inc.*, 406 U.S. 272 (1972).

fundamental soundness of the Wackenhut ILM. If, as labor law implicitly assumes, the duty to bargain is the low-cost procedural mechanism for the establishment and maintenance of efficient ILMs, one would expect Burns to have accepted it voluntarily. But by assuming this duty Burns would have given up an important bargaining chip: the ability to capture a greater share of the joint surplus by misrepresenting to the old employees the state of the product market, the employment markets, or the efficiency of the ILM while taking advantage of the employees' costs of reorganizing a union and the attendant delay.

Similarly, in *Spruce Up*,¹⁸³ the new concessionaire expressed a willingness to hire the old barbers although it rejected the old CBA. By doing so, Spruce Up made clear that it valued the old ILM. In such circumstances, to force employees to reestablish a duty to bargain would disrupt the governance structure of an efficient ILM, giving Spruce Up an opportunity to grab a larger share of the joint surplus.¹⁸⁴

As in Box 4, however, the new employer has no obligation to retain the predecessor's employees, nor has it any duty to bargain if those workers are not retained. Both of these rules protect nonopportunistic, self-enforcing decisions, as was true in Box 4.

In his *Burns* dissent, Justice Rehnquist questioned the relationship between the *Burns* majority opinion and the successorship issues in Box 6. He pointed out that, although the Court "studiously avoids using the term 'successorship' . . . it affirms the conclusions of the Board and the Court of Appeals . . . which were based entirely on the successorship doctrine."¹⁸⁵ Justice Rehnquist then concluded that the *Burns* employees should be protected in the transfer of assets in the same manner as nonlabor claimants, rather than enjoy additional claims not tied to the assets actually transferred.¹⁸⁶ This conclusion, of course, would be the correct result if Box 6 were backward looking, as is corporate law when it applies a conduit theory to protect long-tailed tort claimants. Box 6, however, looks forward and is tied to the continuity of the ILM. The retention of the ILM, and its future sur-

183. *Spruce Up Corp.*, 209 N.L.R.B. 194 (1974), *enforced*, 529 F.2d 516 (4th Cir. 1975).

184. For essentially identical situations, see *NLRB v. New Medico Health Care Ctr.*, 951 F.2d 350 (6th Cir. 1991) (opinion at No. 91-5271, 1991 WL 276260 (Dec. 20, 1991)), *cert. denied*, 112 S. Ct. 2965 (1992); *Auto Mechanics Local Lodge No. 1101 v. NLRB*, 945 F.2d 408 (9th Cir. 1991) (opinion at No. 90-70096, 1991 WL 197005 (Oct. 3, 1991)); *Nazareth Regional High Sch. v. NLRB*, 549 F.2d 873 (3d Cir. 1977).

185. 406 U.S. at 296 (Rehnquist, J., concurring in part and dissenting in part).

186. 406 U.S. at 304-05 (Rehnquist, J., concurring in part and dissenting in part); *see also supra* note 109.

plus, are the key issues, rather than the disposition of the physical assets.

Still, Box 6 cases are unusual. Typically, the retention of the ILM involves the retention of the physical assets of the ILM. The decision to scrap the old assets is likely to relate closely to the decision to scrap the ILM. Hence, Box 6 cases, like *Burns*, are most likely to arise in the context of subcontracting, when the physical assets employed in the ILM belong largely to the contractor and thus are retained with the workers.

2. *Box 5: Obligations Under the CBA After a Shift of Work*

The rule of Box 5 is that, after a shift of work, the new employer need not follow the old CBA.¹⁸⁷ Suppose, however, that the new employer hires all of the loser's employees and deploys them in the same way doing the same work. Why is there no more than a slight and easily rebuttable presumption in favor of the old collective bargaining agreement?

As with Box 6, the ILM considerations that justify the Column 2 boxes largely carry over. Because of the reduced danger of opportunistic behavior, however, those considerations become even more powerful. The paradigm Box 5 case is the potentially efficient ILM, that is, an ILM that is otherwise productive except, say, for uncompetitively high wage premiums. Permitting the Box 5 employer unilaterally to set initial terms maximizes the chances of preserving such ILMs to the mutual benefit of the firm, the employees, and society. Imposing the duty to bargain protects employees from Case C opportunistic behavior. By contrast, imposing the old CBA as the initial terms would doom borderline ILMs to unnecessary extinction.

In *Burns*, the fact that Burns could offer a lower price for the Lockheed contract and still hire a sufficient number of guards to provide the services to Lockheed provides substantial evidence that, while the Wackenhut ILM was fundamentally sound, the wages paid under the contract rendered Wackenhut uncompetitive. By permitting Burns to hire the employees, at a lower wage, the Court allowed for the preservation of the potentially efficient Wackenhut ILM. Imposing the duty to bargain on Burns protected the former Wackenhut guards from any attempt by Burns to capture a disproportionate share of the joint surplus generated by their joint activities.

187. See *supra* notes 103-05 and accompanying text.

D. *Remaining Puzzles*

The preceding account of labor law successorship doctrine leaves several puzzles. First, we distinguish between Case *B* and Case *C* on the grounds that in Case *B*, but not in Case *C*, the new firm's representation that the ILM is defective is self-enforcing. This raises the question why, in Case *C*, employees would *believe* such a representation. The firm's failure in Case *C* to put its money where its mouth is makes its statement inherently suspect.

The answer is related to information asymmetries. While the firm's representation might not be credible given full information, employees lack full information. The firm's information as to the marginal product of the workers is partly private, depending on product prices and technology (known to the firm) and worker effort (known to the employees). This asymmetry of information and the associated potential for opportunistic behavior, we argue, partly explains why parties in a low transaction cost setting would adopt the labor law successorship doctrine.

But opportunistic behavior may still occur, even under an optimal labor law successorship regime. At best, labor law successorship doctrine will maintain and protect a bargaining *process*. Because the ILM creates a bilateral monopoly, however, the outcome of that bargaining process — the division of the joint surplus — will depend on the relative bargaining abilities of the parties. In this process, shrewd negotiators for a firm may successfully manipulate information to argue credibly that product market conditions are adverse when they in fact are favorable, thereby increasing the firm's share.

The second puzzle is related to the first. In the corporate law cases, the law views creditors as largely able to protect themselves by contract. Unknown future claimants represent the principal exception: they cannot protect themselves because they do not know they even have a claim, much less its magnitude, and typically lack a contractual relationship with the firm. But why do we also treat employees differently? Unlike future products liability claimants, employees *do* have an ongoing contractual relationship with the firm. Why should the law do anything more than enforce the CBA?¹⁸⁸

One answer is unpersuasive. Some have argued that the relative absence of explicit contractual protection stems from employee ignorance of the problem of asset purchasers behaving opportunistically.¹⁸⁹ If the problem were one of asymmetric information, however, it would

188. 406 U.S. at 304-06 (Rehnquist, J., concurring in part and dissenting in part).

189. Hylton & Hylton, *supra* note 5, at 849-50.

be self-correcting. As opportunistic behavior becomes known, the hypothesis of continued ignorance becomes less credible. Moreover, it is inconsistent with the presence of successorship protection in some collective bargaining agreements.

A more persuasive justification for this protection is that collective action problems among employees make it difficult to contract for the efficient level of protection. While union leadership may understand the problem of successorship, explaining this problem to the rank and file may prove difficult, especially in terms of a trade-off against wages. This account predicts and is consistent with the casual observation that explicit successorship protection is more common in national contracts — where the rank and file has relatively less impact — than in single plant contracts.¹⁹⁰

The primary explanation for these legal protections, however, is that the ILM is a continuing relationship. While the CBA has a termination date, the parties' understanding is that contract expiration is primarily a time to reset or update some of the parameters of the agreement. Since the parties do not view termination of a CBA, and any intervals between CBAs, as an end to the relationship, the parties retain an ongoing duty to bargain to form a new contract. The duty to bargain continues as long as the relationship remains intact and a new owner who retains the ILM does not disturb that duty. This continuity preserves productive ILMs and thereby benefits both the new employer and the workers.

CONCLUSION

The labor law successorship doctrine has bedeviled courts and labor law commentators for years. To many, it has seemed arbitrary, formalistic, and morally wrong. Traditional labor law scholars, using traditional labor law categories, have been unable to explain or predict its development or provide any sort of justification for its peculiar features.

In this article, we have started from the very formalism that the traditional commentators have rejected — the corporate law distinction between mergers and asset sales. From that distinction, and from a more general analysis of corporate successorship doctrine, we have generated a taxonomy that organizes the doctrine.

Once we organize the doctrine by reference to corporate law's analysis of successorship, we can explain the differences between the

190. Discussion at the University of Pennsylvania's Institute for Law and Economics Labor Law Roundtable (May 1, 1992).

two bodies of law by focusing on the differences in the relationship between employees and the firm and others who contract with the firm. What distinguishes the employee-firm relationship is the existence of ILMs, which, because of match-specific investments, create the potential for ongoing joint profits or surpluses above those offered by ELMs. This potential for continuing profits, however, also creates a greater potential for opportunistic, rent-seeking behavior. By analyzing labor law successorship doctrine from the ILM perspective, with its focus on the forward-looking creation of joint surplus, we can explain why employees receive greater protection in stock and asset sales than creditors receive generally. At the same time, ILM considerations explain why even greater protections, the sort favored by many labor law commentators who use the standard labor paradigm, are not only unnecessary but also potentially harmful to the joint interests of the firm and the workers.

But the ILM perspective alone does not fully explain the complexities of labor successorship doctrine. A full explanation also requires the application of the corporate law paradigm. This paradigm distinguishes between stock sales and mergers — as the standard form mechanism for transferring a whole business as a going concern — on the one hand, and asset sales — as the standard form for transferring businesses piecemeal — on the other.

The relevance of the corporate law paradigm explains why *Wiley*¹⁹¹ was only the first of many cases in labor law successorship. The *Wiley* doctrine could not be applied broadly, as both advocated and predicted by traditional labor law commentators. The *Wiley* issue of contract enforcement following a merger fundamentally differs from the issues that arise in the absence of a contract (Box 2) and from those that arise after an asset sale (Boxes 3 and 4). At the same time, we show why *Wiley*, correctly interpreted, has never been overturned or even limited. It was at the time, and remains today, the correct rule for Box 1 cases.

The relevance of the corporate law paradigm also shows why the Court's assertion in *Howard Johnson*¹⁹² that the nature of the corporate transaction was not a central feature of that case was misplaced. Even when lower courts put the substance of the substantial continuity doctrine ahead of the form of the corporate transaction, they find that the form of the transaction predicts the correct application of the substantial continuity doctrine. Form and substance are closely related.

191. *John Wiley & Sons, Inc. v. Livingston*, 376 U.S. 543 (1964).

192. *Howard Johnson Co. v. Detroit Local Joint Executive Bd.*, 417 U.S. 249 (1974).

To explain the curious application of successorship doctrine to Column 3 shift of work cases, however, the corporate law paradigm is of only limited help. Only the theory of the ILM, which sees the potential for future profits in continuing ILMs, adequately explains the need for protection in such contexts. The substantial continuity of the ILM in *Burns*¹⁹³ is initially a puzzle because the new owner neither purchased the stock nor the assets of the predecessor. The explanation for this puzzle is that many of the ILM's physical assets were owned by the contractor, Lockheed. When Lockheed shifted the work from Wackenhut to Burns, the impact on the ILM was almost identical to an asset sale.

This article illustrates the power of economics to cast light on similar legal doctrines that develop in related fields. Capital and labor are two of the principal inputs to the firm. Both corporate law and labor law address the problem of successorship, of the extent to which those who acquire the firm in whole or in part must assume the obligations of the seller. We show in this article that many of the differences in labor and corporate law's treatment of successorship derive from fundamental economic differences in the firm's relationship with creditors, as suppliers of capital, and its relationship with employees, as suppliers of labor.

193. *NLRB v. Burns Intl. Sec. Servs., Inc.*, 406 U.S. 272 (1972).